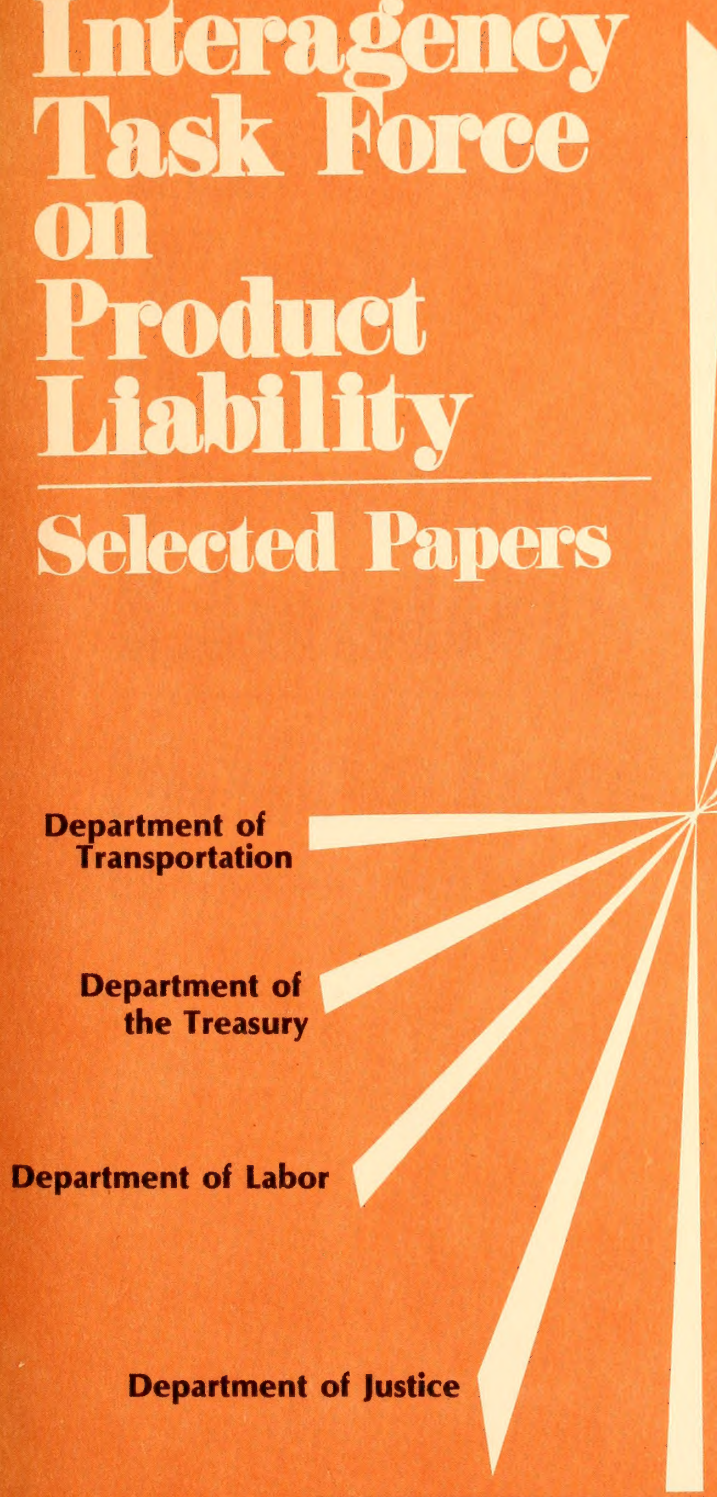
C1.66/5:P11

Interagency Task Force on Product Liability

Selected Papers



PENNSYLVANIA STATE UNIVERSITY
JUN 15 1978
DOCUMENTS COLLECTION

DISTRIBUTED BY:
NTIS

PB-278-625



Digitized by the Internet Archive
in 2012 with funding from
LYRASIS Members and Sloan Foundation

http://archive.org/details/interagencytask00unit

Interagency Task Force on Product Liability

Selected Papers

U.S. DEPARTMENT OF COMMERCE

U. S. Depository Copy

THE TASK FORCE

The Task Force was chaired by Under Secretary of Commerce Sidney Harman. The other agencies participating as Task Force members were:

Council of Economic Advisers

Department of Health, Education and Welfare

Department of Housing and Urban Development

Department of Justice

Department of Labor

Department of Transportation

Department of the Treasury

Office of Management and Budget

Small Business Administration

Advice and assistance provided by:
Consumer Product Safety Commission

THE GOVERNMENT STAFF

The Working Task Force:

o Victor E. Schwartz, Professor of Law	Chairman
o Council of Economic Advisers	Susan Lepper David McNichol
o Department of Commerce	Samuel B. Sherwin Kenneth Gordon
o Department of Health, Education and Welfare	Peter Konijn
o Department of Housing and Urban Development	Howard B. Clark James Brodsky
o Department of Justice	Ronald Gainer Neil Peterson
o Department of Labor	Robert Copeland Edward Bergin
o Department of Transportation	Richard Walsh
o Department of the Treasury	Wolf Haber Dr. James Van Horne
o Office of Management and Budget	Richard Sheppard Edward Clarke
o Small Business Administration	Maureen Glebes
o Consumer Product Safety Commission	Edward Heiden Paul Gatons

Project Director:

o Edward T. Barrett, II

Editor

Donald W. Smiegiel

Assistant Editor

Josephine Powe

Administration Support and Secretarial Staff

Carol D. Kindig	Editorial Assistant
Melinda J. Rossi	Editorial Assistant
Patricia S. Pearson	Secretary to the Project Director
Barbara Campbell	
Gladys Joseph	

Layout Advisor

B. P. C. van der Burgh

TABLE OF CONTENTS

	Page
INTRODUCTION	1
PART I: Advisory Committee on Product Liability	
Introduction	5
Membership	6
Meetings	7
Advisory Committee Members' Comments on Draft Final Report	40
Ralph B. Baldwin	43
Melvin Block	46
Judy Braiman-Lipson	58
Robert Clements	61
Vincent Graham	74
Frederick Juer	84
Eugene M. Kennedy	87
James H. Mack	88
Daniel J. McNamara	101
Staff Analysis of ISO Comments	110
Edward J. Noha	128
Judge Ned Price	147
Fred G. Secrest	164
Charles W. Stewart, Jr.	166
Richard D. Wood	175
PART II: PRODUCT LIABILITY SYMPOSIUM	179
PART III: WORKING TASK FORCE MONOGRAPHS	332
Wade, Preliminary Comments on the Products-Liability "Crisis" (1976)	333
Olson, Selected Mechanisms for Insuring Product Liability (1976)	346

Page

Oi, Products Liability and Industrial Safety (1976) 391

Bernsweig, Some Comparisons Between the Medical Malpractice and Product Liability Problems (1976) 417

PART IV: THE CONSUMER PERSPECTIVE 446

Anita Johnson 448
Ralph Nader 456
Benedicte Federspiel 466

PART V: PRODUCT LIABILITY SURVEYS--TRADE ASSOCIATIONS . . . 477

MAPI, "Products Liability: A MAPI Survey" (August 1976) 479

MAPI, "Dimensions of the Products Liability Problem" (April 25, 1977) 522

NFIB, "NFIB Survey Report on Product Liability" (January 1977) 529

APPENDIX

"Report of the Senate Select Committee on Product Liability" (December 30, 1977) to the Missouri State Senate 548

SELECTED PAPERS OF THE INTERAGENCY TASK FORCE ON PRODUCT LIABILITY

Introduction

This volume contains selected papers utilized by the Interagency Task Force on Product Liability in its study of product liability. These materials were thought to be of value to legislators, researchers, and other persons interested in the product liability problem. They include papers which set forth the perspectives of the various interest groups concerned with and affected by the product liability problem. Also included are materials which state the views of experts of various academic and professional disciplines with respect to that problem. Most of these materials have not been published previously.

This volume is divided into five parts and an appendix. The first part contains documents relating to the Product Liability Advisory Committee to the Under Secretary of Commerce. As will be described in more detail later, that Advisory Committee was formed by the Secretary of Commerce to advise and inform the Under Secretary about the product liability problem and proposed remedies to that problem.

The documents relating to the Advisory Committee are the minutes of the four Advisory Committee meetings held during the course of the Task Force's study and the written comments of individual members of the Advisory Committee regarding a draft version of the Final Report which was reviewed by them prior to that report's publication on November 1, 1977.

Part II contains an edited version of the transcript of the proceedings of the Symposium on Product Liability held at the Department of Commerce in July 1976. The purpose of the Symposium was to generate new ideas and perspectives about the product liability problem. Ten of the foremost experts on product liability in the United States were present at the Symposium. They included the Reporter of the Restatement (Second) of Torts, an author of one of the leading casebooks and treatises on the topic of product liability, an acknowledged academic expert on the topic of insurance, a leading expert on no-fault compensation systems, experienced plaintiff and defense attorneys, a government economist, and professors of engineering and economics. Their names are listed in the transcript.

Part III contains four monographs prepared at the request of the Working Task Force on Product Liability. The first

monograph, Preliminary Comments on the Products-Liability "Crisis" (1976), was written by John Wade, who is a Distinguished Professor of Law at the Vanderbilt Law School and Reporter of the Restatement (Second) of Torts. Professor Wade participated in the Symposium on Product Liability.

The second, Selected Mechanisms for Insuring Products Liability (1976), was prepared by Douglas G. Olson, Associate Professor of Insurance at the Wharton School of Business, University of Pennsylvania. Professor Olson was also a participant in the Symposium on Product Liability and prepared his paper under contract with the Task Force.

The third paper, Products Liability and Industrial Safety (1976), was written by Professor Walter Y. Oi, Chairman of the Department of Economics at the University of Rochester. Professor Oi also was a participant in the Symposium on Product Liability and is a leading expert in the area of the economics of industrial safety.

The fourth monograph, Some Comparisons Between the Medical Malpractice and Product Liability Problems (1976), was prepared by Eli P. Bernzweig, then Special Assistant to the Administrator of the Federal Insurance Administration of the Department of Housing and Urban Development. Mr. Bernzweig was formerly the

Executive Director of the staff of the commission which studied medical malpractice at the Department of Health, Education and Welfare in 1973.

Part IV contains three statements regarding product liability by representatives of U.S. and foreign consumer groups. These statements were included because of the importance of the consumer perspective to the formulation of an objective and balanced solution to the product liability problem and because they were frequently cited in the Final Report. The first statement is that of Ms. Anita Johnson, representing the Health Research Group of Public Citizen, Inc., which she delivered at the fourth meeting of the Product Liability Advisory Committee on June 27, 1977.*/ Part IV also includes the statements of Mr. Ralph Nader, President of Public Citizen, Inc., and Ms. Benedicte Federspiel, Director of the Legal and Economic Division of the Danish Consumer Council, at the First World Conference on Product Liability in London, England on January 21, 1977.

---

*/ Ms. Johnson is currently an attorney-advisor with the Environmental Defense Fund.

Part V includes two trade association surveys on product liability which were conducted by the Machinery and Allied Products Institute and by the National Federation of Independent Business. Both surveys were previously unavailable to the Task Force for reproduction in the Final Report or the Industry Study. They were included in this volume because they were frequently cited in the Final Report.

The appendix to this volume contains the text and one appendix of the "Report of the Senate Select Committee on Product Liability" (December 30, 1977) to the Missouri State Senate. This report was completed after the publication of the Task Force's Final Report and was therefore not utilized by the Task Force staff. It has been included, however, because it is the most recently completed state study of product liability that has come to the Task Force's attention.

Part I: Advisory Committee on Product Liability

A. Introduction

In order to gather information about product liability problems and potential solutions to them, the Secretary of Commerce

formed an advisory committee on product liability comprised of various groups affected by those problems. The committee advised the Under Secretary, who provided liaison between the Task Force and his Advisory Committee and assured that there was an exchange of information between the two groups regarding product liability problems and the Task Force's study.*/

B. Membership

The committee was chaired by the Honorable Ned Price, member of the State Board of Insurance of the State of Texas. Initially it was comprised of 19 member-representatives of large and small manufacturers, distributors, retailers, insurers, insurance brokers, consumers, labor, and the practicing bar. Seven additional persons were added in January 1977, including a representative of the service industries. The names of the members are set forth below.

Judge Ned Price (Chairperson), Member of the State Board of Insurance of the State of Texas
Ralph B. Baldwin, President, Oliver Machinery Company
Melvin Block, Attorney at Law
Judy Braiman-Lipson, President, Empire State Consumer Assoc., Inc.
William M. Brooks, Senior Partner, Brooks Burke Surgical Supply Co.
Jacob Clayman, Secretary-Treasurer, Industrial Union Department, AFL-CIO
Robert Clements, Senior Vice President, Marsh & McLennan, Inc.

---

*/ The Under Secretary of Commerce chaired the Interagency Task Force on Product Liability.

John Russell Deane III, Attorney at Law
Vincent Graham, Vice President, Merchandise Admin., Sears, Roebuck & Co.
Lloyd Hackler, President, American Retail Federation
Dr. Clare G. Johnson, Physician
Frederick Juer, President, Worth Bat Company
Eugene M. Kennedy, President, Whitin Machine Works
John Koch, Attorney at Law
James H. Mack, Public Affairs Director, National Machine Tool Builders Association
Joseph McEwen, President, Modern Handling Equipment Company
Daniel J. McNamara, President, Insurance Services Office
Edward J. Noha, Chairman of the Board & Chief Executive Officer, CNA Insurance Companies
Paul Rheingold, Attorney at Law
Fred G. Secrest, Executive Vice President, Ford Motor Company
John J. Sheehan, Legislative Director, United Steelworkers of America
Charles W. Stewart, Jr., President, Machinery and Allied Products Institute
William H. Wallace, Attorney at Law
Edward B. Wilson II, Chairman of the Board, J. Walter Thompson Company
Richard D. Wood, Chairman of the Board, Eli Lilly & Company
W. Thomas York, President, AMF Inc.

C. Meetings

The Advisory Committee met four times during the course of the Task Force's study. The initial meeting was held on September 20, 1976. Its purpose was to gather the perspectives of the various interest groups concerning the product liability problem. At the second meeting, which was held on November 1, 1976, the members were asked their views on approximately 30 remedial proposals that had been brought to the attention of the Task Force. At the January 11, 1977

meeting, the members discussed the Briefing Report, which had been published by the Task Force on January 4, 1977. The fourth meeting of the Advisory Committee was held on June 27, 1977. Its purpose was to evaluate the Task Force's three independent contractor studies in the insurance, industry, and legal fields. Specific questions were directed to the committee members regarding any perceived shortcomings in those studies and their views on whether the product liability problem had changed since 1976.

The Task Force staff utilized the information provided by the Advisory Committee in preparing the Final Report. This is reflected by the numerous citations in the Final Report to the transcripts of the four Advisory Committee meetings described above. Although it was not practicable to reproduce the transcripts*/ of those meetings, the minutes of those meetings follow.

---

*/ The transcripts are available for inspection at the U.S. Department of Commerce, Washington, D.C.

Minutes of the First Meeting
Advisory Committee on Product Liability

Time: September 20, 1976, 9:30AM

Place: New Executive Office Building
Washington, D. C.

Attendees: A list of the members and government attendees is attached

Summary of Discussions:

The Under Secretary welcomed the members. He reviewed the assertions received by the Department and other agencies that the system of allocating the cost of injuries caused by products is breaking down with increased cost of insurance or the lack of availability of insurance.

The Under Secretary called on the members to comment on the specific aspect of product liability issue which had been previously sent to them and asked that they see both sides of the issue when making the presentation.

Professor Victor Schwartz, Task Force Project Director, outlined the organization and purposes of the Task Force study. The purposes include: determining the cost of the product liability claims to individual manufacturers; determining the source of those costs; and making recommendations as to how these costs may be reduced. Each possible solution should increase the availability of insurance at affordable premiums; expedite the reparations process; place risk prevention incentives where they would do the most good; and place the cost of the accident on the parties who are best able, in the light of all relevant factors, to distribute the cost at a product risk.

Professor Schwartz discussed remedial measures that had been proposed. These include state reform of tort law including a statute of limitations based on the time of sale of the product, limitations on damages awarded for pain and suffering, an elimination or alteration of the collateral source rule, alterations in the contingent fee systems, limitations on

expert testimony as to who may qualify as an expert, the use of court appointed experts, a modified system of no fault insurance and the use of an assigned risk plan.

Committee Chairman Price spoke about the work of the National Association of Insurance Commissioners' Task Force on Product Liability to obtain data on the extent of the product liability crisis.

Then each of the members addressed the meeting. Mr. Koch pointed out that there are three unique aspects to product liability litigation. These are: the problem of machinery used for a long period of time; that use and misuse of a product may come from the hands of third parties, not like ordinary tort situations; and workers' compensation laws often prevent a manufacturer from being able to shift his loss onto an employer of an injured worker.

Mr. Secrest noted a determination must be made about the fairness of product liability claims awards. If they are fair, then the prices of products involved would have to rise to meet the costs. If they are not reasonable,then some or all of the proposed remedies should be pursued. He noted that the proposals for changing the rules for products liability were of less concern to large companies than small. Large manufacturers can absorb increased costs - to a point. But he questioned the advisability of a public policy that would have different sets of rules for large and small companies. He questioned also a situation that would cause small companies to sell out to large companies in order to seek the financial strength needed to meet a problem such as products liability.

Mr. Juer noted that sporting goods manufacturers are mostly small businesses. They have seen a tremendous increase in premiums which either must be passed on to consumers or profits will decline. They do not feel that the cost problem should be passed to the consumer but that other remedies must be found.

Mr. McEwen discussed problems facing wholesale distributors including the rapid rise of insurance rates, the unavailability of insurance, their exposure to bankruptcy and their inability to properly defend themselves under the present system of tort litigation.

Ms. Braiman, President of the Empire State Consumers Association, spoke briefly on the need for government standards for consumer products.

Mr. Block stated that there is a need for data from insurance companies to document the size of the product liability crisis. He said that an Association of Trial Lawyers of America review of federal and state court dockets revealed no alarming rise in the number of complaints. The reporting system also showed no tremendous rise in the size of judgments being awarded to successful plaintiffs.

Mr. Brooks gave a short discourse on the problems of small distributors. In addition to rising premiums and unavailability of insurance, many are forced to discontinue service contracts because of their possibility of increased exposure to lawsuits.

Mr. Rheingold, a professor of law and a practicing plaintiff's attorney, stated that he doubted the existence of a crisis as large as has been feared. He also cautioned the members not to rush headlong into solutions that restrict or eliminate an injured consumer's right to compensation.

Mr. Sheehan noted that there was a growing feeling in the labor movement toward a system that would ensure safety in the work-place. If this safety cannot be achieved by regulation, then the tort system might be an incentive to employers to provide a safe workplace. He noted also that where workers' compensation benefits were inadequate, the tort system may be used to fill the breach.

Dr. Clare Johnson spoke of the need for additional data from insurance companies on the number of suits, the cost of the suits, fees paid to defend such suits, etc.

Mr. Clements stated that the problems of rising premiums and inadequate availability of insurance have hurt the smaller manufacturers to a greater degree than others.

He noted that part of the problem was the result of a transition in which underwriters are trying to adjust prices to reflect the awards being made in circumstances where they would not have been in the past. He noted also that there was an imbalance in supply and demand for products liability insurance which would correct itself.

Mr. Baldwin stated that some small businesses were being wiped out. He suggested the use of a time of sale based statute of limitations. He also stated many companies were afraid to introduce new designs and models because of the possibility that they could be used as evidence of the older models' lack of safety features.

Mr. Ronald Jacks, representing Edward Noha, Chairman of CNA Insurance Companies, stated that the insurance industry is working to develop figures so the exact dimensions of the product liability crisis could be accurately measured.

In response to questions, Mr. Clements discussed availability of insurance and its relationship to product liability claims. He defined "bad risks" as products that did not work well enough for underwriters to insure. He indicated that if they could not be insured they probably should not be in the marketplace.

Professor Schwartz, in response to a question, outlined the history and function of the American Law Institute and the Restatement of Torts. He pointed out that the Restatement was used as a guide by many judges.

Mr. Block, in response to a question, explained the contingent fee system. He stated that a 1/3 fee is a fair and adequate fee. He feels that lawyers will only take sound cases under that system because of the time and effort involved.

Dr. Johnson also commented on the contingent fee system. He felt that there should be a reduction in fees obtained by attorneys in the larger award cases. He also stated that persons with a small damage case would go uncompensated because no attorney would handle it.

Mr. Rheingold commented on the call for a statute of limitations based on the time of sale. He felt that products liability does not readily conform to a statute of limitations based on the time of sale, in part, because of the variety of injury-causing products and the problem of cutting off rights before an injury occurs.

Messrs. Baldwin and Brooks pointed out the problems in their respective industries from suits based on defects in products made a long-time ago.

Mr. Block outlined the jury system and its potential review by the judge and appellate judges.

Mr. Baldwin stated that despite the review, there are serious problems with the jury system reaching decisions for the wrong reasons.

The Committee will meet again on November 1, 1976.

Thereupon at 2:30 P.M. the meeting was adjourned.

Attendees

Initial Meeting

Advisory Committee on Product Liability

New Executive Office Building - Rm.2010

Baldwin, Ralph B. - President - Oliver Machinery Company

Barnert, Douglas - Assistant Deputy Commissioner - State Board of Insurance (Texas)

**Barrett, Edward T. - Product Liability Task Force - Committee Control Officer

Block, Melvin - Member of Executive Committee - American Trial Lawyers' Association

Braiman, Judy - President - Empire State Consumer Association, Inc.

Brooks, William M. - Senior Partner - Brooks Burke Surgical Supply Company

Clements, Robert - Senior Vice President - Marsh & McLennan, Inc.

*Cook, Howard - American Retail Federation

**Flannagan, John C. - Product Liability Task Force Staff

**Glebes, Maureen C. - Small Business Administration

**Gordon, Kenneth A. - Special Assistant to the Under Secretary of Commerce

Ireland, Evelyn F. - NAIC Coordinator - State Board of Insurance (Texas)

*Jacks, Ronald A. - General Counsel - C.N.A. Insurance Companies

Johnson, Clare G. - Attorney and M.D.

**Jordan, Donald - Product Liability Task Force Staff

Juer, Frederick - President - Worth Bat Company

Koch, John - Attorney - Covington & Burling

*Madden, J.J. - Eli Lilly & Company

*Representing members
**Government employees

McEwen, Joseph - President - Modern Handling Equipment Company

*Michelson, Lawrence - Sears, Roebuck & Company

Price, Ned - Senior Member - State Board of Insurance (Texas)

Rheingold, Paul - Attorney

**Schwartz, Victor E. - Product Liability Task Force - Project Director

Secrest, Fred G. - Executive Vice President - Ford Motor Company

Sheehan, Jack - Legislative Director - United Steelworkers of America

**van der Burgh, Charles E. - Product Liability Task Force Staff

**van Lawick, Marsha L. - Product Liability Task Force Staff

**Vetter, Edward O. - Under Secretary of Commerce

*Representing members
**Government employees

Minutes of the Second Meeting
Advisory Committee on Product Liability

Date: November 1, 1976

Place: Room 6802 Main Commerce Building

Attendees: A list of members and government attendees is attached

Summary of Discussions:

Committee Chairman Price called the meeting to order and welcomed the members. He introduced the representatives of the contractors to the Interagency Task Force on Product Liability, Gordon Associates, McKinsey and Company, and the Research Group. Under Secretary Vetter announced the appointment of Jacob Clayman, Secretary-Treasurer the Industrial Union Department, AFL/CIO, a new member of the committee.

Victor Schwartz, Task Force Project Director, provided a progress report on the study. He noted that the December 15 deadline was still the target. He discussed Working Paper #2 on remedies which further develops the remedies discussed in Working Paper #1 and introduced new proposals. Because of evaluative comments included in the paper, it has been restricted to distribution among members of the Task Force and therefore only an edited version was provided to the Advisory Committee members.

The new remedies discussed are:

a. The useful life concept - how can standards be established and by whom.

b. Standards for expert testimony.

c. Periodic payments as a more efficient method of compensation.

d. Captive insurance companies - changes in laws needed to facilitate them.

The major discussion of the meeting concerned questions generated by the last meeting and issues to be addressed by the Task Force.

The questions are:

1. "We would like to have a better focus on the cost of products liability insurance as a percentage of sales. Several figures were mentioned by the members and have been reported to us by others. Is there any standard "rule of thumb" that can be used? Do your trade associations have data available on current costs in your industries?"

The concensus of the members seemed to be that there was no rule of thumb which was easily attainable. Most people felt that one-two percent was probably the general range of premium costs to sales, but some members alleged that the range was very broad, with particular segments of industry having a much higher percentage of premium costs.

The need for specific data was continually reiterated. Mr. Block suggested that the information, if it does indeed exist, could better come from the insurance industry rather than respective manufacturers or industries.

He stressed the continued lack of evidence of whether there was a bona fide insurance crisis.

Professor Schwartz then reformulated question #1 to ask whether the costs of products have been measurably increased due to the increased cost of product liability insurance.

Mr. Madden (for Mr. Woods) felt it fair to say that the cost of individual insurance had not been a significant item in product prices per unit. He emphasized rather the catastrophic potential of product liability and the absence of insurance experiences. Some members were concerned that there were indeed a few manufacturers that could not obtain product liability insurance at all, but that it was very difficult to come up with statistics and averages

because of the great variance between segments of industry and products themselves. Mr. Baldwin gave a tentative report on the nearly complete survey being conducted by the National Woodworking Machinery Manufacturers' Association, which substantially supported these concerns.

Mr. Clements suggested that products liability premiums, as a percentage of sales, were probably on the average, much less than 1%, but stressed that this method of looking at product liability may not be representative of the true impact on the small manufacturer. He felt that the committee rather needed to look at the available capacity of the insurance industry to take risks, and further noted that the major problem of the manufacturer is that very likely, even though he is paying less than 1% of sales, he does not have as much insurance as he would purchase if the market would make it available to him.

2. "Manufacturers often state that a major products liability problem concerns suits brought as a result of injuries suffered on very old equipment. Some data on this has been made available to us on this problem and some examples cited at the last meeting. We would like to discuss this problem more fully. Any data that is available to you would be most helpful.

This general subject will be considered in our discussion of "useful life" criteria and state of the art defenses.

Mr. Weisgall suggested as an alternative to a useful life standard, that if a machine is built to certain government standards, it is certified as built with the best available technology and thereby no product liability suit can be brought against it. This system is used in various forms in some European countries, and Mr. Weisgall urged the necessity of looking at these European systems of dealing with product liability.

Mr. Sheehan voiced concern that the useful life concept must also be looked at from the worker point of view, and it should not be forgotten that though a machine has passed the statute length, it often nevertheless still continues in operation A statute of limitations does not solve a safety problem.

Mr. Baldwin pointed out that the crucial definition of "defective product" or "defective machine" has not yet been ascertained, and that,until that has been done,the only protection an old line company has is a statute of limitations type of law.

It was pointed out that Working Paper 2 had attempted to show the limitations on the concept of a "defective" product. There were two potential limitations: (a) the unavoidably dangerous product (which the law in most states has not held the manufacturer liable, if sufficient warning is given) and (b) a useful life limitation.

Mr. Baldwin then proceeded to share the National Safety Council report on work injuries with the Committee members.

Mr. Weisgall, in response to the remarks from Mr. Sheehan and Mr. Baldwin, suggested that a statute of limitations might be somewhat arbitrary since it barred suit on a machine 11 years old yet allowed suit on a machine 9 years old. Rather, he suggested that the party best able to control the safety of the machine should have the responsibility for the injury. Furthermore, he suggested that the employer would be best able to implement accident prevention control systems. This may represent some sort of compromise between the interest of the worker and the manufacturer.

Mr. Rheingold questioned whether most manufacturers would be willing to accept a useful life concept since they would have to indicate clearly when the useful life of their product ended, which may have a negative effect on sales.

Mr. Sheehan summed up the response to question 2 by reiterating that a statute of limitations still does not solve the safety problem, nor are the ramifications of a useful life concept as yet fully explored.

3. "There was some discussion of the relationship between inadequate workers' compensation levels and the use of the tort system to achieve adequate monetary recovery from an injury. The workers' compensation system protects a manufacturer on one side but may expose him to additional suits on the other."

There was disagreement among members as to whether increasing the level of benefits substantially without including a sole remedy provision would reduce the incentive of employees and employers to make third party claims. Mr. Clayman pointed out that at the very least worker's compensation should cover the full economic loss of the employee. He felt that, at present, employers were probably often not willing to pay for full economic loss, much less the pain and suffering, distortion of family, etc., that attach to a work injury.

4. "In comments about attorney's contingent fees, some felt they generated frivolous suits and other comments indicated they helped prevent such suits. We would like to discuss this further. While the level of those fees is relevant to the discussion, we are more interested in the concept itself and how it affects products liability suits."

Mr. Block said that, as a matter of fact, most of the people who are in work-related accidents because of the defective product and injury, cannot afford the rates which other plaintiffs pay, and, as a matter of fact, the contingent fee is that person's only access to the legal system. He also stressed that the contingent fee, because it hits manufacturers in the pocketbook, has done more for remedial reform than has legislation and regulations. To attack the contingent fee is to keep the plaintiff out of the courtroom, and thus leading to an immunity of manufacturers for defective manufacturing processes.

Mr. Noha pointed out that there is a lot more to know about the contingent fee system. He wondered if contingent fees were the prevalent system and in how many instances is someone so poor that they could not use the legal system except through using the contingent fee system. He suggested that the Trial Lawyers Association set up a pool for those who cannot gain access to the courthouse, similarly to an industry setting up a pool when there is market unavailability or insurance unavailability.

Professor Schwartz in response to a question said that the Task Force is attempting to find out what percentage of the premium dollar goes to legal costs, but cautioned that the figures would only be estimates because the Insurance Services Office closed claim survey would not be available by the time the study ended.

Mr. Clayman suggested that the whole contingent fee apparatus is a reflection of the failure of the worker's compensation system to provide equity to the worker. There are workers who cannot afford a lawyer on their own who need a contingent fee system. He further suggested that same levels of fee rates be set out to deal with the often exorbitant contingent fee.

There was some discussion on what states had passed legislation dealing with contingent fees, if any, or what states were attempting to deal with the issue through regulation.

5. "There was comment that the insurance industry has not supplied data to support the increase in product liability premiums. We would like to discuss this subject more fully. Are there data available which have not been released for policy reasons,and if so, what are those policy reasons? Are there claims and loss data available to trade associations that would tend to support the need for these increases? Are product liability premiums stated separately or included with general liability premiums? Have other liability premiums increased at a commensurate rate to product liability?"

Mr. Block mentioned the proposed questionnaire the Trial Lawyers Association had sent to the Select Committee on Small Business,at the request of Senator Javits, that dealt with the basic data needed to answer questions about the insurance industry. He read the questionnaire for the benefit of the committee members, and stated that those questions needed to be answered before the rights of injured workers could be limited. Mr. Noha pointed out that ISO was presently compiling information which would provide answers to question five, to which Professor Schwartz said that the ISO results would not be available until after the Task Force Report came out.

6. "Clearly some members feel there is an urgent need for remedial action in the short term to provide time to devise long range solutions. Others feel there is no crisis. We would like to discuss this further. We are particularly interested in determing whether there may be a genuine crisis in limited segments of the economy but not a broad problem."

There was some discussion as to whether and to what extent some companies were affected by product liability. It seemed that some segments were being severely harmed while others were not. Mr. Baldwin presented some preliminary survey

statistics as to the extent of the harm among woodworking manufacturers. There was an interest, however, above and beyond specifics, in dealing with the implications of product liability for the whole economy, rather than attempting to assign responsibility for the current problem to one group or another. In fact, a few members felt that whether there were specific data or not on the nature of the insurance problem was irrelevant, since the basic problem was product liability suits themselves and their excesses, while the insurance industry and other industry problems were temporary factors in the current problem at best.

Some disagreement was generated. Mr. Clayman stressed that it was crucial that the committee have serious credible evidence that a crisis really existed. Without such evidence, the recommendations of the committee would be nothing more than opinions based on the backgrounds and prejudices of the committee's individual members.

Mr. Noha pointed out that, though as yet there was no hard evidence of a general availability crisis, there was significant evidence that some segments of the industry were having a problem. He noted the insurance companies' obvious interest in selling as much insurance at as profitable a price as the market could bear. When that price reached the point where the increased costs could no longer be passed on to the consumer, then it seemed as if an important problem existed that needed to be addressed. Was it an insurance industry problem, an industrial problem, or more likely, a result of the operation of the current liability system?

Under Secretary Vetter responded by pointing out that ultimately the government must be concerned about unnecessary costs that are being passed on to the consumer, be they because the insurance industry is charging more than they need, or because contingent fees are higher than they should be, or because of companies making faulty products. He stressed the major concern regarding costs to the consumer.

Professor Schwartz introduced the list of issues confronting the Task Force. Professor Schwartz presented the first issue, and stressed that it was a thesis that had been presented to the Task Force and did not represent the results of any facts which the Task Force had gleaned.

1. "Approximately five years ago the insurance industry was "overcompeting" for large manufacturers' product liability risks in order to obtain the cash-flow inherent in large deposit premiums. The insurance companies invested a portion of these in equity markets. The excessive competition for these large risks often resulted in premiums being set too low in light of the potential liability exposure.

When the equities in which the insurance companies had invested fell, there was corresponding reduction in policy-holders surplus. Since the financial solidity of insurers is sometimes gauged by the ratio between their premiums written and policy-holders surpluses, they had to reduce their writings in the line or lines that were most suspect from the standpoint of profitability.

It is alleged that the net result of all of this is that the small, manually rated risks (which received no benefit from the earlier competition for cash flow) are now impacted with the heaviest burden of product liability insurance premium increases (or inability to secure insurance). Any comments on the validity of thesis?"

Mr. Clements felt there was a fair amount of validity to the thesis, but nevertheless took issue with the statement that small manually rated risks received no benefit from the earlier competition for cash flow. In his experience in buying insurance for large and small manufacturers, the benefit received was the same.

The thesis is related, said Mr. Clements, to the available capital in the insurance industry and its ability to absorb risks. It is natural that what capital there is goes first to take risks than can be best quantified and last to the risks that are more difficult to measure. Therefore, action to make new investment in the insurance industry attractive was a reasonable method of attracting capital specifically to the writing of product liability insurance. One method was an exemption from that aspect of regulation for insurance capital that was going to be devoted specifically to the business of writing product liability insurance. Regulation occurs in 50 states and involves participation in involuntary acceptance of risk through participation in programs such as assigned risk plans and joint underwriting authorities.

A second method would be a tax incentive for investment in an insurance venture to write this kind of insurance, with funds going to an established insurance company, or into an entirely new insurance venture.

Mr. Noha added a few remarks among which was his serious doubts that small company product liability premiums were helping to subsidize large companies.

2. "The problem created by variable state tort law rules is so great that some have suggested that a uniform federal law of product liability is necessary. Even if that law were plaintiff-oriented (for example, it adopted the essentials of strict liability as set forth in Section 402A of the Second Restatement of Torts), would the uniformity it provided represent an improvement over the present system?"

Responses concerning the need for federal tort law ranged from no need at the present time to a middle ground between the present situation and having the Federal government take over the entire responsibility. One suggestion was that the Federal government urge that states adopt uniform laws defining strict liability to narrow the interpretive gaps. Some felt that such a uniform law geared towards narrowing the inconsistencies in interpretation of strict liability as a whole. Mr. Rheingold suggested that the problem really concerned a question of state common law versus a Federal statutory law, and that he preferred the "patch-work quilt" of common law.

Professor Schwartz pointed out a number of reasons underlying this question. One was that preliminary reports indicated that a modification in tort law, even if favorable, would not have an immediate impact on liability insurance until there was state uniformity. Second, realism is important to keep in mind; that is, the likelihood that Congress would pass a totally manufacturer-oriented law is probably slim.

Issue #3 was not discussed since it had been dealt with in depth under the question on the useful life concept. It is included in the minutes for the record.

3. "How could legal criteria for the useful life of a product be established and who should have the power to make that determination?"

4. "Would a no-fault system for product liability as designed by Professor O'Connell be utilized by companies if they had the legal power to do so?"

Professor Schwartz clarified the O'Connell no-fault system and noted that this plan was of interest particularly because it represented neither a consumer point of view nor a manufacturer point of view.

One committee member responded that no-fault would probably be quite attractive, particularly in a durable goods industry, and pointed out that worker's compensation was a form of no-fault which could be improved by increased payments and getting rid of the third party action. However, he voiced concern that the manufacturer of honestly shoddy equipment gets a free ride out of no-fault, when it may be better for the industry as a whole to have that company go out of business as a result of a large product liability claim, and certainly it would be better for the consumer.

Professor Schwartz explained that no-fault still held the manufacturer or defendant liable for injuries caused by his product, and that he would still have to pay claims, but those claims would not be as high as presently. He also noted that Professor O'Connell has said that even under the present system the consumer does not fare very well.

5. "To what extent are small businesses going without insurance even though they may not have the necessary cash flow or capital to cover potential product liability judgments that may be rendered against them"?

Mr. Baldwin presented the results tentatively reached from his association's survey.

Committee Chairman Price opened the afternoon session of the meeting by eliciting questions from representatives of the independent contractors. Mr. Gordon of Gordon Associates was recognized, and he provided the committee with a progress report on the status of the industry study, outlined the methodology of the research, and then presented two questions for the committee's response.

Mr. Gordon asked the committee whether it saw the locus of the product liability crisis as currently divided between those products which are used in the workplace and those products sold generally in the marketplace to consumers. The second question related to the first--whether the committee members felt that workplace products were generating most of the problems, and whether the committee saw several avenues of relief for that problem.

Responses ranged from statements that the crisis was equal in both areas, to being 99% consumer-oriented, qualified by the fact that the ultimate effect on prices and inflation of claims related the two areas closely. The latter characterization of the crisis was reiterated by several members. Mr. Noha suggested that it might be more useful to look not only at the incidence of claims but also the dollar amounts,since the heavier dollar amounts in industrial sectors may counterbalance the greater number of claims that are consumer related.

Mr. Orban presented the progress report from The Research Group and outlined its procedures and goals. He had one question for the committee members which was specifically addressed to insurance company representaitves. It concerned whether, as a remedy, the shifting of the burden of loss from one defendant party(e.g., the manufacturer), to another (e.g., the employer) or some sort of comparative fault system would be of any consequence to the insurance companies.

The response was generally negative, since the insurance industry deals in the aggregate, and the dollar amounts of the insurance would be the same. However, it was pointed out that though the dollar amount may be the same, the burden on the manufacturer may not be as great since conceivably the employer was bearing part of the loss. It was also pointed out that a positive effect of such a shifting of burdens could increase the incentive on the person held at fault to improve his product or safety standards, and therefore such a system was very important to risk prevention.

Mr. Dutter presented the insurance industry progress report from McKinsey and Company, and reviewed the objectives of its research efforts, its present status, and asked a number of questions of the committee members.

Mr. Dutter's initial question was rather a plea. He stated that hard information concerning unavailability was hard to come by and responses were not as specific as they could be, i.e., relatively few responses clearly identified themselves as being unable to get products liability coverage at a reasonable price. Answers were simply too general.

Mr. Dutter was also interested in comments from the committee on the use of standards, either OSHA or CPSC, as a possible defense, and particularly asked for views on the feasibility and acceptability of such an approach. Responses to the latter question were very positive, both as a state of the art-type defense, and as a boon to risk prevention. In response to Mr. Dutter's first comment, Mr. Clements suggested that statistics supporting the unavailability of insurance would be exceedingly rare. However, he felt it important that McKinsey and Company look at the amount of insurance companies were able to buy now compared to that amount in previous years, as indicative of the decreased availability of product liability insurance.

Mr. Dutter's final question concerned what could be done to make it more feasible to form captives or for groups to get together to do something about the problem of availability and cost of coverage. Two significant reasons were given why this alternative had not been considered as frequently as it might. One was the industry's "fear of the unknown"; it was difficult for companies to agree to band together, since they had little way of assessing the results of their union in advance. More importantly, perhaps, serious antitrust problems were raised by such insurance practices, as well as difficulties involving reserves and the IRS. It was suggested that the contractor talk to the Justice Department for its views.

Professor Schwartz introduced the condensed version of the revised remedies paper, which he characterized as a broad list of proposed remedies for comments and discussion by the committee members. Particular remedies were discussed,

such as a federal statute of limitations, government re-insurance, state of the art defenses, etc.

Mr. Secrest related the individual experience of the automobile industry with a particular type of statute of repose. The issues rapidly centralized: whether a way can be found, without denying a person legitimately injured by manufacturing and design defects, or without penalizing them, to reduce exposure, and whether compensation can be ruled out for injuries caused predominantly by the negligence of the user.

The comparative fault system was mentioned frequently as an excellent method of dealing with these issues in long range terms. Less amenable to relief were items such as the cost of premiums in the short range under such legal remedies. Professor Schwartz pointed out that until new rules of law are tested and interpreted by the courts, there might be no product liability premium reduction.

It was suggested that a combination of specific award limitations, and a statute of limitations may substantially reduce the overall costs of product liability, which may have a more immediate effect on the state of the industry. One member pointed out that the lack of predictability at present in product liability was a major source of the problem in the cost of premiums. Correspondingly, statutes of limitations, standard defenses, uniform laws and interpretations were all suggestions given as ways of increasing the predictability for the insurance industry, and thus lowering premium costs.

Professor Schwartz requested comments on the impact of the unavailability of product liability insurance on large manufacturers. Responses indicated that there was little specific data that large manufacturers had at present been impacted; nevertheless, the feeling was that if product liability premium rates increase at the present rate, if claims increase as they have been, then it will not be long before large manufacturers will be affected.

Professor Schwartz also specifically requested comments on the role that state or Federal Government should play in setting standards for risk prevention and safety.

Discussion thereon revealed that,at present,the government did provide standards, through OSHA, CPSC, as did some insurance companies and the American National Standards Institute. Professor Schwartz noted that the Task Force is studying the extent of the risk prevention services provided by the insurance companies.

Discussion and questions by the members of the Committee in response to the revised remedies paper touched on quality control versus defective design problems, whether dealer-retailer negligence increased suits against manufacturers, the risk distribution concept, and "unavoidably unsafe" products under the Restatement 402A.

The last item on the meeting's agenda invited public comment on the discussions and problems that had occurred at the day's meetings. An ISO representative noted for the record that many of the issues involved at today's meetings would be answered by its document which would be available "soon".

Mr. Orban mentioned that impact of changes in the law, such as mandatory insurance, no fault, captive trade associations or insurance companies on foreign importers and exporters. He questioned whether these remedies would be open to such people, and whether the possible effect that these remedies would become non-tariff barriers to foreign trade and thus have an impact on foreign relations, had been considered by the Task Force.

Other comments highlighted the differences between quality control, quality assessment, quality assurance, and the possibility of professional liability of the assessors or validators. Professor Schwartz informed the public that some of the issues and areas mentioned would not be covered by the Task Force, and the specific scope was outlined in the Scope of the Research statement in the Federal Register.

ATTENDEES

ADVISORY COMMITTEE ON PRODUCT LIABILITY

Members

Mr. Ned Price,
Chairman

Mr. W. Thomas York

Mr. Fred G. Secrest

Mr. Ralph B. Baldwin

Mr. Frederick Juer

Mr. Jerome Madden for
Mr. Richard D. Wood

Mr. Loyd Hackler

Mr. Vincent Graham

Mr. Jonathan Weisgull for
Mr. John Koch

Mr. Melvin Block

Mr. Paul Rheingold

Mr. Robert Clements

Mr. Edward J. Noha

Mr. Jack Sheehan

Dr. Clare G. Johnson

Government Employees

Edward O. Vetter

Victor E. Schwartz

Kenneth E. Gordon

Edward T. Barrett

Contractors

Jerry Gordon
Gordon Assoc.

Philip Dutter
McKinsey & Company

Frank Orban
The Research Group

Minutes of the Third Meeting
Advisory Committee on Product Liability

DATE: January 11, 1977

PLACE: Room 4830 Main Commerce Building

TIME: 1:00 p.m.

ATTENDEES: A list attached

Summary of Discussions:

The Under Secretary opened the meeting, stating that he would be Chairman pro-tem because Chairman Price had been delayed in Memphis, Tennessee and would be unable to attend. He reviewed the background leading to the publication of the Briefing Report of the Interagency Task Force on Product Liability, the subject of discussion for this meeting.

Professor Schwartz spoke about the Briefing Report. He explained that it is preliminary in nature and does not utilize all of the information that will be included in the Task Force's Final Report. Furthermore, the Briefing Report is a highly condensed summary of the information analyzed by the Task Force. The Final Report will be much more substantial in nature and cover topics not mentioned in the Briefing Report. Professor Schwartz emphasized that the Report does not represent any interest group's point-of-view. Rather, it is an objective report that balances the views of competing interest groups. He noted his belief that the value of the Report is enhanced by its objectivity.

Professor Schwartz emphasized that the Report is not the voice of the Commerce Department, but rather the work and views of several agencies which took an active role in the preparation of the Report.

Finally, he pointed out that the Report contains suggestions that have the potential of providing product liability relief to those who need it without compromising the right of injured consumers or workers to receive just compensation.

Professor Schwartz then discussed some of the findings of the Task Force. Among these were substantial increases in product liability premiums from 1974-76. The most severely affected industries were industrial machinery and chemicals, pharmaceuticals, automotive parts, medical devices, sporting goods and ladder manufacturers. However, the Task Force received

very little correspondence regarding unavailability of insurance coverage. The Task Force found a severe problem for a limited number of groups, but not a broad-scale problem which affected everyone.

Professor Schwartz noted that there were several factors that contributed to the product liability problem which the Task Force felt had to be considered unalterable as far as the Task Force was concerned. These included inflation and increasing consumer awareness of their right to sue.

Professor Schwartz then outlined the causes of the product liability problem which the Task Force addressed. The first cause is that product liability insurance ratemaking procedures make it very difficult to get accurate information on insurance company profit and loss. The second cause is uncertainty in product liability law. The third cause is that a few manufacturers are not making product safety and quality control a high priority item. He noted that this attitude is changing with the increased attention on product liability claims.

Among the short-range remedies outlined by the Task Force for further attention were a national product liability insurance voluntary pooling mechanism, captive insurance companies, and a Federal standby reinsurance mechanism, although the latter recommendation is somewhat hedged.

Possible long-range solutions were divided into consumer and workplace categories. In the workplace category, the first remedy is to permit a contribution claim by a product manufacturer against an employer whose negligence contributed to the employee's injury. The second possible remedy would be to make workers' compensation the exclusive source of recovery for employees injured in the course of employment.

Professor Schwartz also mentioned a no-fault compensation system as a possible option that must be investigated.

Mr. Clements of Marsh McLennan said that he was surprised that the high cost of the tort system did not receive more attention. He also emphasized that the means of establishing product liability insurance rates have good and valid reasons and that perhaps a better way to rate tort liability of a manufacturer is to rate all of the liability of the business. He voiced skepticism about the concept of a Federal insurance pool as pooling mechanisms tend to produce a self-perpetuating artificial cost. Finally, he said that the correlation between adequate workers' compensation benefits and the frequency of claims received only minimal attention in the report whereas Marsh and McLennan's study indicates that inadequate workers'

compensation benefits are a cause of tort claims against manufacturers.

Professor Schwartz asked that any information regarding a correlation between low worker compensation payments and the number of claims brought by injured workers be provided to the Task Force.

Mr. Ralph Baldwin of Oliver Machinery Company observed that he would not expect suits to stop with higher workers' compensation payments because you are dealing in a sense with human cupidity. A worker sees a chance to get additional money for himself through a lawsuit without any loss to himself.

Mr. Baldwin also stated that he was disappointed that more specific recommendations were not made to help out the industrial concerns threatened with real problems in 1977.

Mr. Graham of Sears, Roebuck and Company complimented the Task Force for its work. He added that the difficulty of collecting data relating to product liability makes it difficult to quantify the problem.

Mr. McEwen of Modern Handling Equipment Company stated that one cannot minimize the effect of capital goods manufacturers on the economy. He also stated that his product liability rates as a wholesaler rose one percent (of the amount of goods distributed). This is in addition to the cost of the manufacturers'product liability insurance. He also expressed fear that domestic manufacturers are being penalized and that foreign manufacturers may be picking up that business.

Professor Schwartz noted that foreign manufacturers that send goods into this country are subject to liability the same as domestic manufacturers.

Mr. John Koch, an attorney who represents the National Machine Tool Builders Association, said that product liability, notwithstanding the fact that it is not a crisis, is a problem that is deserving of high priority attention. He emphasized the effect of uncertainty on manufacturers. He stated that making workers' compensation the sole recovery for workplace injuries would eliminate a great deal of uncertainty. He felt that the concurrent problems that would come with this suggestion would not be insurmountable. He also said that a defendant should be able to implead employers so that a court could cancel out liability related to the respective fault of the parties.

His one criticism of the report was that it failed to come out and affirmatively endorse a limited and interim solution.

Jack Martin of Ford Motor Company (for Mr. Secrest) asked Professor Schwartz to explain liability without fault. Professor Schwartz commented on strict liability and said that the matter would be discussed fully in the Final report.

Fredrick Juer of Worth Bat Company, referring to the 1% of sales cost of insurance, warned the committee against being misled by averages as certain segments of the economy are being hard hit, specifically smaller companies.

Professor Schwartz stated that Chapter 3 of the Final report will present these variables in detail so that no one is misled by average figures.

Mr. William Brooks of Brooks-Burke Surgical Supply Company said he was very disturbed that at no point in the report was the plight of wholesale distributors discussed.

Mr. Melvin Block of American Trial Lawyers' Association stated that the report gave a fair view of the product liability problem. He emphasized aspects of the report which said that the tort liability system induces manufacturers to produce safe products. He noted that business opposed federal intervention in many areas but called for federal laws to remove tort victims'rights.

Mr. Juer observed that manufacturers recognize that a person injured should be compensated when the manufacturer is at fault.

Mr. Noha of C.N.A. Insurance Companies emphasized that a pooling arrangement will not change the cost of product liability insurance. Merely shifting product liability costs to the workers' compensation system would be inadequate. He felt that the real problem was the lack of predictibility in the present system.

Professor Schwartz emphasized the point made in the Briefing Report that it was not feasible to cut off the workers' rights without giving something in return. Secondly, with workers' compensation as a sole remedy, there would be some saving of transaction costs. Two problems would have to be resolved if this remedy was pursued. First, the benefits would have to be increased. Second, manufacturers of defective products would have to contribute to the workers if their products caused the injury.

Mr. Sheehan of the United Steelworkers of America was concerned about the suggestions of making workers' compensation the exclusive remedy. He said that workers' compensation has not been an inducement to safety in the workplace. He also stated that he felt that organized labor will never feel that the workers' compensation rates are high enough to constitute an exclusive remedy for the injured worker. He noted also that workers want a safe workplace and the current liability system may be an inducement for that.

Mr. Richard Wood of Eli Lilly and Company stated that he feared our legal system has moved closer to absolute liability. He mentioned that one side effect of this has been that some manufacturers have chosen to forego or delay the introduction of new products. He noted also that there was no mention in the report of the legal fee system or legal ethics.

Mr. McEwen said that the problem was a multi-faceted problem which had to be handled at the state level. He asked that recommendations of the National Wholesale Distributors Association be entered in the record. Recommended State actions are: strict liability, a state of the art defense, a statute of limitations, a limitation on contingent fees, a limitation on punitive damages, a Product Liability Review Panel, and Workers' Compensation as an exclusive remedy.

Mr. Clements noted Mr. Woods comment on the absence of discussion of the legal fee system. He asked if it would be discussed in the final report.

Professor Schwartz said that the final report will include ISO data on product liability costs which states that of every dollar paid out, 42 cents goes for total defense, 85% of that is for legal defense costs. The available information will be developed in the Final report.

During the time allotted for public comment, Tom Fahey of Associated Industries of New York State said that several organizations within his association had experienced very large increases in their product liability premium rates making it unaffordable for some manufacturers.

Charles Stewart of the Machinery and Allied Products Institute felt that the deadlines imposed on the Task Force were too extreme for a proper study of a problem as complex as product liability.

Chairman Vetter then adjourned the meeting at 4:00 p.m.

ADVISORY COMMITTEE ATTENDEES AND ALTERNATES

Mr. W. Thomas York

Mr. Ralph B. Baldwin

Mr. Jack Martin For
Mr. Fred G. Secrest

Mr. Frederick Juer

Mr. Richard D. Wood

Mr. Joseph McEwen

Mr. William M. Brooks

Mr. Don White For
Mr. Loyd Hackler

Mr. Vincent Graham

Mr. John Koch

Mr. Melvin Block

Mr. Robert Clements

Mr. Edward J. Noha

Mr. Ned Price

Mr. Jack Sheehan

Dr. Clare G. Johnson

Minutes of the Fourth Meeting

Advisory Committee on Product Liability

Date: June 27, 1977

Place: Main Commerce Building (Room 6802)

Time: 9:30 a.m.

Attendees: See attached list

SUMMARY OF DISCUSSION:

There was a slight shift from over a year ago in the members' attitude about the need for federal legislation in the area of product liability. As a group, the members seemed more positive about it. The main opposition to a federal approach would appear to come from some insurance companies, the National Association of Insurance Commissioners, and the Defense Bar. Of course, Fred Secrest of Ford Motor Company probably reflected the view of many others when he remarked that he could endorse a federal approach if he knew what it said. In sum, both the fact that product liability rates are formulated on a nationwide basis and the variance in state legislative reaction to the product liability problem appear to have created the greater interest in a federal approach.

In general, the group did not challenge any of the basic findings of our Industry Report. This is important because the industry telephone survey was not conducted on a scientific basis. In particular, the sample size was too small to produce statistically reliable data regarding the target product categories or business in general.

It would appear that major criticism of the Industry Report came from Joseph McEwen, who represents distributors. Product distributors were not included in the industry telephone survey. Apparently our staff attempted to have data collected by the National Association of Wholesaler-Distributors, but that

group did not carry out our suggestions. Professor Schwartz indicated that the Working Task Force would try to include some information in the Final Report as to how the product liability problem has affected distributors. Apparently, although they are successful in litigation, they are made to bear substantial defense costs.

There was relatively little criticism of our Insurance Study. This contrasts with the view of some members of Congressman LaFalce's subcommittee (Capital, Investment and Business Opportunities) who have suggested that the report was not totally objective. The basis for this suggestion appears to be the failure of the Task Force's insurance contractor to conduct a careful critical evaluation of insurance companies' rate-making practices and their profit and loss statements.

Representatives from the machine tool industry indicated that limited data available to them show that insurance rates are continuing to rise at a substantial rate, as are claims and the cost of claims. Nevertheless, they have conducted no new major studies about these issues.

A surprising number of the Advisory Committee members were interested in a federal remedy that would allow companies (under limited conditions) to create a tax-exempt reserve for potential product liability claims. Although our contractor studies did not develop this remedy, we anticipated that there might be some interest in it and will present a discussion of it in the Final Report. The Department of the Treasury might have suggestions about this remedy. Therefore, we have sought an informal opinion about that remedy from that Department's Working Task Force representative.

A number of members believed that the federal government could help the product liability problem by supplying product safety information to small businesses which have been unable to obtain it. It was also suggested that the Insurance Services Office supply such data to businesses.

Whereas insurers and some businesses stressed "data gathering" at the beginning of our study, they now suggest that past data can only give a glimpse of the future. In that connection, they stress that uncertainty in the legal system leads insurance underwriters to "fear the worst" and raise rates substantially. This indicates the need for careful thinking about stabilizing the system.

Ms. Anita Johnson (of the Health Research Group of Public Citizen, Inc.) warned the Advisory Committee that measures that would adversely affect the consumer were no way to solve the product liability problem. She suggested that manufacturers were just now facing up to their responsibilities for hazards caused by their products.

Her statements were probably helpful to the group in re-emphasizing the political realities with respect to some of the measures they have proposed to the Task Force. We have kept consumer (and labor) interests in mind in our discussions of remedies, but this does not sit well with some manufacturing interests who want swift and certain curtailments placed in the tort system.

The representative from the Insurance Services Office stressed the significance of the National Association of Insurance Commissioners' new voluntary product liability insurance placement program. He suggested that this will help resolve the product liability problem.

A number of Advisory Committee members noted, however, that the program only addresses the problem of the availability of product liability insurance, not problems of affordability. Our data show that affordability situations are the more important part of the product liability problem.

ADVISORY COMMITTEE ATTENDEES AND ALTERNATES

Mr. Ned Price

Mr. Robert Clements

Mr. John R. Deane III

Mr. Charles Derr for
Mr. Charles Stewart

Mr. Vincent Graham

Mr. Ronald A. Jacks for
Mr. Edward J. Noha

Dr. Clare G. Johnson

Mr. James H. Mack

Mr. Joseph McEwen

Mr. Daniel McNamara

Mr. Paul Rheingold

Mr. Fred G. Secrest

Mr. Stephen A. Stitle for
Mr. Richard D. Wood

Mr. William H. Wallace

Mr. Edward B. Wilson II

D. Advisory Committee Members' Comments on Draft Final Report

In addition to participating in the four meetings described above, the Advisory Committee members were asked by the Under Secretary of Commerce to review and comment on a draft version of the Final Report of the Interagency Task Force on Product Liability. That draft had already been reviewed and approved by the member agencies of the Task Force.

The Advisory Committee was not chartered to, and did not, approve or disapprove of the contents of the Final Report. Therefore, the pre-publication review of the draft by the Advisory Committee was limited to eliminating any factual errors identified by the members. They were very helpful in that regard.

The Under Secretary also asked the Advisory Committee members to set forth in writing their views about the conclusions and opinions expressed in the Final Report, stating that the Department would print those views in a separate volume to be issued at a later date.

Fourteen members availed themselves of this opportunity. Their unedited written statements are set forth below in alphabetical order by author.

Ralph B. Baldwin, President, Oliver Machinery Company, represented small capital goods manufacturers.

Melvin Block, attorney at law, was a member of the Executive Committee of the American Trial Lawyers' Association, which represents the plaintiff's bar. Mr. Block's statement was concurred in by Mr. Paul Rheingold, who is also an attorney representative of the plaintiff's bar.

Judy Braiman-Lipson, President, Empire State Consumer Association, Inc., represented consumers.

Robert Clements is an Executive Vice President of Marsh & McLennan, Inc., one of the nation's largest insurance brokerage firms.

Vincent Graham, Vice President for Merchandise Administration at Sears, Roebuck and Company, represented large retailers.

Eugene M. Kennedy, President of Whitin Machine Works, represented large capital goods manufacturers.

James H. Mack is the Public Affairs Director for the National Machine Tool Builders Association.

Daniel J. McNamara is the President of the Insurance Services Office (ISO). ISO is an unincorporated association of insurance companies which provides statistical, ratemaking, and research services for the property-liability insurance industry. (The page numbers referred to in Mr. McNamara's commentary are those of the draft version of the Final Report. Because of the detailed nature of that commentary, the corresponding page numbers in the Final Report are indicated parenthetically after each comment.)

Edward J. Noha is the Chairman of the Board and Chief Executive Officer of the CNA Insurance Companies.

Judge Ned Price, member of the State Board of Insurance of the State of Texas, served as the Chairman of the Advisory Committee. Judge Price represented the National Association of Insurance Commissioners.

Fred G. Secrest, Executive Vice President of Ford Motor Company, represented large consumer product manufacturers.

Charles W. Stewart, Jr. is the President of the Machinery and Allied Products Institute, an association of capital goods manufacturers. That association conducted a product liability survey of some of its member companies which is reproduced in Part V of this volume. (See p.

Richard D. Wood, Chairman of the Board of Eli Lilly & Co., represented large consumer product manufacturers.

OLIVER MACHINERY CO.

GRAND RAPIDS, MICHIGAN, U.S.A. 49504
AREA CODE 616 456-1591 • TELEX 22-6483

October 21, 1977

Mr. Edward T. Barrett, II
Project Director
Interagency Task Force on Product Liability
Room 5412
United States Department of Commerce
Washington, D. C. 20230

Dear Mr. Barrett:

I have had only parts of two days to skim through the draft of the final report of the Interagency Task Force on Product Liability. Consequently I cannot give a detailed analysis of its strengths and weaknesses; however, from what I have seen and what has appeared in preliminary drafts and the multi-volume reports of contractors, I have reached certain definite conclusions.

The Interagency Task Force was given an impossible deadline and was inadequately funded. The report is based upon telephone contacts made with individuals representing only 337 companies plus personal interviews with 20 selected firms in high risk industries and reviews of product liability surveys from 20 national trade associations.

These data are woefully inadequate to outline the product liability problem and, in particular, the continuing evolution of the problem. They are already obsolete. Consequently, it is improbable that a really meaningful report could be developed.

Most of the information received by the Task Force had an effective date in the middle of 1976. Many things have happened since that time and in some ways the picture has become substantially worse. Let me illustrate with only two examples. In the middle of 1976 there were 13 companies manufacturing football helmets. Today there are only three. Some of the 10 have gone out of business. Most have been absorbed by larger companies. Similarly, information was furnished the Advisory Committee that of the 97 members of the Woodworking Machinery Manufacturers of America, 4 had gone out of business while 10 others were going bare and that many others did still have insurance at rates ranging up to at least 10% of their sales volume. As far as I can tell, none of this information reached the final draft.

The Briefing Report and the three studies and the final draft treat the product liability issue much more as a concern of the manufacturing sector than as a problem affecting wholesaler-distributors and other non-manufacturer sellers. I believe the emphasis should be more nearly equal.

While the matter is mentioned, I find no place in any of the publications where the real effect of the cost of product liability insurance, plus the costs within individual companies, are related properly to the net profits of the myriads of companies affected by product liability insurance. Such costs not only threaten

the existence of many companies but represent a significant cause of inflation as as these costs are compounded down the distribution chain. This economic impact is felt on all levels of manufacture and distribution. It is, however, highly erratic in that two quite similar companies may have widely differing costs due to product liability, and this makes it extremely difficult for the higher cost company to compete.

With the exception of one sentence which says that perhaps 95% of product liability suits are settled before going to trial, I have found no evidence of a real appreciation of the fact that the great majority of product liability suits are frivolous and due exclusively to the negligence of the injured party, often aided and abetted by the negligence of his employer. Elliot Rosenberg has called this "the sue and settle syndrome" and it represents a very substantial portion of the costs of product liability today.

There is no real appreciation in the final draft that the way we are handling the product liability situation in the United States flaunts common sense and equity.

Similarly, the draft discusses on page II-5 et seq. the difficulties inherent in determining what constitutes a defect. The sentence in Section 402A of the 1965 Restatement of Torts that defines strict liability does so by the use of a term "defective product unreasonably dangerous" and this term is so thoroughly misunderstood that courts and juries find themselves free to interpret it according to their emotions.

There is no real appreciation that the lawyers of this country, both plaintiff and defense, have built up a multi-billion dollar industry which they are not about to relinquish. The best figures I have been able to find indicate that more of the money that changes hands in product liability matters goes to the plaintiff and defense lawyers than it does to injured parties.

There is little evidence in the report that old line firms whose products have been in the field for many years are unduly penalized relative to younger firms making similar products.

There is no place in the draft that points out that the product liability crisis is not an insurance crisis but is an ethical crisis. No manufacturer or distributor I know will claim immunity from liability if he is responsible fully for the accident, but under any concept of ethics with which I am familiar, it is wrong to force a manufacturer or distributor to pay for the negligence of someone else. If society as a whole wants an injured person to be recompensed for injury from any cause, then society as a whole must pay the costs under some form of general taxation. It is clearly evident that the American society will be severely damaged if it endeavors to implement this philosophy by having specific private companies carry the load.

In my opinion the issuance, nearly a year ago, of the preliminary report, has done irreparable harm to American industry. The issuance of the final draft in its present form will compound this injury. The Task Force itself, composed largely of lawyers, has tried so hard to outline various points of view concerning the product liability situation that its impact can only be negative and will not help in solving a very real problem.

In my opinion the final draft is superior to the preliminary draft, particularly since it eliminates the sentence in the latter that emphasized that there was no crisis. The preliminary report should be completely withdrawn from circulation. The final draft discusses numerous suggested remedies without making specific recommendations. The impression will thus be spread widely, by those who have a vested interest in the present situation, that there really is no problem. This report will not help America solve a growing problem.

Sincerely,

Ralph B. Baldwin
President

RBB:mo

STATEMENT OF MELVIN BLOCK, Member of the Advisory Committe to the Inter-Agency Task Force on Product Liability, U. S. Department of Commerce

---

The confrontation continues between those who desire laws, rules and regulations which allow people to live in good health and those who wish for laws, rules and regulations which allow special interests to live better at the expense of the populace. However, the latter can gain no consolation from the findings of both the Interim Report (IR) and Final Report (FR) of the Federal Inter-Agency Task Force (IATF). It is not the voice of the turtle that is heard throughout the land, but instead those who self-servingly cry wolf.

In short, the reports are a lethal blow to a mercenary, mendacious mythology of crisis and alarm fomented by the insurance industry and echoed by those in a position to gain.

The Final Report further finds that there is an abysmal absence of data from the insurance industry even after continued pleas via the Federal Register and dissemination of the need for same to the presumably most interested parties in the insurance industries and others who created the call for the InterAgency Task Force. This absence of supportive data makes it impossible to confirm whether any insurance price increases

in the area of products liability are indeed justified.(FR I-20)

Furthermore, according to the findings of the Task Force, available data supplied by those most interested failed to establish a crisis "in the sense that a large sector of industry cannot obtain products liability insurance or that the increased cost of such insurance has made a substantial impact on the price of many products". (IR 40) Indeed, the Task Force study could not have reached any other conclusion. On the same page (IR 40) it is stated that the study "should do more to preclude precipitous legislative action and duplicative research efforts, than to find a total 'cure-all' for products liability problems".

The utility of any system such as the tort-litigation system cannot be measured solely by economic factors. The IATF has recognized that the rights of injured victims are paramount and has placed special emphasis upon the deterrent effect of the present products liability system. Consumer products are involved in accidents which annually kill 30,000 people, permanently disable 110,000 and hospitalize 585,000 more (see the 1970 Report of the National Commission on Products Safety). This appalling body count underscores the continuing need for a system which efficiently induces product safety. Moreover, this toll excludes factory, farm, construction and transportation products injuries.

The Final Report verified the fact that the insurance industry and business community were making invalidated extraordinary assertions. The figure of one million products liability claims for the year 1976 was stridently bandied about by the industry. The hearings disclosed that the insurance industry now has drastically revised its still unverified estimate to 60,000.00 to 70,000.00 claims. Perhaps, a minimal disparity to anyone concerned with actuarial statistics. Insidious propaganda of this type, according to the report, has helped create a false "crisis" atmosphere. (FR I-3)

This statement will briefly examine the IATF's analysis of the cost of maintaining the present system of deterrence and will briefly illustrate the efficacy of the system. Also, we will discuss some proposals for increasing the efficiency of the tort-litigation approach.

I IS THERE A LEGITIMATE CRISIS?

Those who advocate a change in the products liability system claim that the cost of products premiums has increased dramatically. However, the IATF report found that, "in most industries, even those affected by a sharp increase in products liability premiums, that cost has accounted for less than 1% as a percentage of sales." (Emphasis added) (IR 6) (FR III-2) When one compares this figure to the $300 that a $10,000 a year

laborer must spend annually on his automobile insurance, the relative insignificance of products liability premium cost is underscored. Compared to the relative losses often suffered by an injured plaintiff, the cost to the manufacturer of products liability insurance is infinitesimal. In addition, the Final Report finds that since 1972, there has been no significant change in the average amounts paid per firm being proferred in products liability awards, according to the surveys. (FR III-3)

The above figure of less than one percent of sales is even more impressive when one considers that it is based on conclusions from an independent telephone survey of 337 producers evely distributed among small, medium and large organizations, an analysis of products liability surveys conducted by 17 national trad associations, and solicitation for information in the Federal Register. Surely, those most interested in draconian remedies would have responded with alactrity at the opportunity to corroborate their own mythical thesis.

In the surveys conducted by the national trade associations, only a 20 percent response rate was elicited. The implication of this disinterest on the part of many manufacturers would seem to be that only few of them are experiencing a problem of being able to afford insurance. Furthermore, the less than one percent figure might be inflated, since one might expect that only those with an extraordinary affordability program would

respond to either the Federal Register's solicitation or the trade association studies.

In addition, the IATF report indicates that the availability problem is an isolated one. The Final Report found that there is no widespread problem of availability of products liability insurance of the firms responding to the various surveys. (FR III-2) A few companies in high risk product lines were having difficulty. (FR VI-81) There is no direct verifiable evidence that products liability insurance has been the cause of any business failure. (FR VI-81)

Therefore, to solve this initial problem, we would support either a voluntary pooling mechanism as discussed in both studies. Notably, an advisory committee to the National Association of Insurance Commissioners has supported the suggestion of a voluntary pooling mechanism. A plan is now successfully operating in Connecticut. Implementation in other states can be expected to eliminate any availability problem which exists. Indeed a staff report indicates it could be only 0.1% of American business who possibly could have an availability-affordability problem. (IR 8)

Significantly, the Final Report questions the reserving practices of the insurance companies. The precise impact of reserves for incurred losses, including incurred-but-not-reported (IBNR) losses, on product liability underwriting losses, rates,

and the determination of the profitability of the line is still unresolved.

Similarly, the Task Force staff has not been able to directly address the issue of whether or not the unpredictability inherent in the reparations and insurance systems lend itself to a continuing redundancy in the reserves. The entire area of reserving practices is one that has been the subject of considerable debate which appears certain to continue. It is an area in which there is a vital need for more objective study. (FR V-30)

Finally, the implications of the recent Insurance Services Office (I.S.O) Closed Claim Study would seem to be that there is no crisis.

The Final Report clearly indicates the need for more information before any tampering of the tort litigation system is contemplated. It states that better data should be collected for all product liability insurance premiums, losses and claims. The Final Report finds that product liability insurance rates and premiums should be regulated to ensure that they are more closely related to statistical assessments of and are fair, nondiscriminatory and reasonably related to product risk. (FR V-40)

Also, there is a need to promote greater financial disclosure and accountability in product liability insurance. (FR V-41)

In conclusion, the Task Force believe that steps outlined herein will help address the so-called product liability problem. They might also reduce pressure for extensive government involvement in the area of product liability insurance regulation. (FR V-42)

The statistics which are available on such questions as the actual cost per claim, date of sale of the product, and the relative compensation which the average claimant received in relation to his economic loss seem to suggest that there is no manufacturers 'crisis' in products litigation.

II THERAPEUTIC EFFECT OF TORT-LITIGATION SYSTEM

It has been suggested that the purpose of the tort system is twofold: (1) to compensate those injured by the faults of others and (2) to discourage tortfeasors from continuing tortious activity. Nowhere in the tort system are these purposes better achieved than in the products liability case.

One of the most practical measures for preventing accidents in the field of product failure is the successful lawsuit. In finding that (1) the tort-litigation system and increased premiums have been an effective spur toward inducing manufacturers to produce safe products. (IR 10) and that (2) premiums still

amount to less than one percent of the gross sales, the IATF has thus confirmed that the present system is cost effective.

The Final Report acknowledges and reaffirms the fact that products litigation helps place the incentive for risk prevention on the party or parties who are best able to accomplish that goal. (See Industry Study I-9 and I-10) (FR VII-5)

The final version of the industry study and other information that has come to the attention of the Task Force reaffirms its prior finding that the tort-litigation system and the increased products liability insurance premiums have caused a number of manufacturers and insurors to devote more time to and reinforce their activities in products liability prevention. (FR VI-70-4)

The most common approaches undertaken are:

1. Augmented quality control
2. Improved labeling
3. Product redesign

These three techniques are viewed as having a significant impact on product safety. (FR VI-76)

It also results in better research and development, and involvement and re-education of top management. (FR VI-77)

Many insurance companies have increased their efforts to provide product liability prevention advice to their insureds. (FR VI-78)

Evidence of the salutary function of products liability suits abound. Two examples suffice:

Tip-over steam vaporizers, true to that ominous description with regularity in the past severely burned the young and the unaware with scalding water. Not even the withdrawal of products liability insurance could influence the manufacturer to change his design. When, finally, claims against this palpably defective product numbered over 100, the manufacturer was found to redesign the vaporizer with a single cover-lock top. (See Hamper, Product Safety v. Reliability: Know the Difference, 44 Machine Design 25) (July 9, 1971).

A cover-lock top is not necessarily suitable for a container of granular drain cleaner. However, if water is introduced into a can of drain cleaner containing lye, it creates a chemical reaction producting heat and converting the water into steam. A cover-lock top, confines the pressure until an explosion occurs. Nevertheless, one manufacturer did continue to package its drain cleaner with cover-lock tops until a great number of claims were brought for injuries caused by exploding cans. Only then did it redesign the container with the current 'flip-top' of 'snap-can' covers. (See Moore v. Jewel Tea Co., 253 N.E. 2d 636 (Ill.App.1969), affirmed 264 N.E. 2d (Ill.1970).

As the IATF indicates, there is a "strong social policy trend that seeks to protect the consumer in spite of his own carelessness". (IR 10) That is an eminently human, reasonable and compassionate policy reinforced by the products liability system and coinciding with our increased regard for all human rights. Thus, in supporting the continued protection of the consumer, the IATF has stated, "in considering any modifications of the tort-litigation system, one must be careful not to diminish pressure on manufacturers towards employing sound products liability preventing technique programs. (IR 10)

The Final Report pragmatically states that, "we do not believe that one should creade a state of 'affordable' product liability insurance with adequate coverage to all manufacturers", ... "more specifically the law should not be modified as to who are both unwilling and unable to follow reasonably safe manufacturing standards". (FR VII-4)

In addition, the summary concludes that immunizing changes in the law of state-of-the-art, custom and usage and compliance with standards are self-defeating in that manufacturers would operate according to the lowest common denominator. (FR VII-29-33)

III THE IATF REPORT - FURTHER SUGGESTIONS FOR CONSIDERATION

An egregious inadequacy of the IATF report is its failure to recommend programs for reducing the number of defective products on the market. Without defective products, there would be no litigation, and no premiums to be paid, high or low. There are still an inexcusably high number of products related injuries occurring each year. We would suggest that, if legislation is forthcoming, it should be to obtain high standards for manufacturers to produce safer products.

Legislation ought, for example, to be enacted which would penalize manufacturers for failure to initiate safety design programs.

Although the marketplace now makes its own adjustments for lack of safety programs, eg: underwriters adjust premium rates on the basis of a manufacturer's concern for safety, these adjustments do not sufficiently protect consumers. Mandatory guidelines for safety design programs should be established.

It is not uncommon for a manufacturer to design a product with a defect which repeatedly causes injury. As recounted above, a steam vaporizer was produced by one manufacturer which caused severe injuries to over 100 people. Yet, despite notice of numerous injuries caused by products, manufacturers too often refuse to recall or redesign their products. The IATF study has

made no recommendation regarding this problem of the chronic offender. We suggest that a better system be established for reporting injuries caused by defective products and that action be initiated, either civilly or criminally, against manufacturers who fail to respond to the design inadequacies of their products which repeatedly cause harm. Corporate recidivism cannot be tolerated.

Finally, the IATF study omits any discussion of management accountability. Where conscious design choices prove to be totally inadequate, and where management wilfully fails to correct the problem, management should be held personally responsible. The recidivism of a products supplier who delivers defective goods should not be tolerated and the corporate shield which protects the culpable officers personally should be removed.

It is a paradox that those who are the first to advocate the curtailment by government of the great heritage of common law rights of our people are the very same industries, corporations and persons to view with alarm any necessary involvement of the government in their affairs. The insurance industry, trade associations and manufacturers should look to the mote in their own eyes.

Concurred in by Paul Rheingold

STATEMENT OF JUDY BRAIMAN-LIPSON, CONSUMER REPRESENTATIVE

The Task Force Report exposes much of the misinformation being used by manufacturers and insurors to promote anti-consumer legislation on product liability. Since state legislators have been fed much misinformation, the Task Force should ensure that they learn the findings of the Report.

The Report finds that business is not being ruined by product liability insurance rates. While rates have been increased by insurance companies, they remain, on an average less than 1% of total sales, and have not, contrary to the propaganda, been the cause of any identifiable company going out of business.

The Report finds that one million product liability lawsuits are not filed annually, even though this figure has been used by insurance companies to create fear of consumers swamping the court system. Best estimates are that about 1/15 of this figure are filed, which means that injured consumers are using the court system more to settle their grievances than they have in the past, but not dramatically more, particularly in the context of increases in all kinds of litigation. Product liability cases still represent a miniscule proportion of all legal cases.

The Report shows that recent increases in the cost of insurance premiums are not justified by any objective facts. While some increase in rates appears to be justified, if nothing else than because of high inflation of medical care and other costs, the astronomical increases appear to be set merely because of "bad vibes" insurors have about the future. Insurors say they have bad vibes because of pro-consumer legal doctrines developed by the courts in the

last twenty years. They have requested a number of incautious remedies not because of any evidence that the remedies will cut the rates manufacturers are complaining of, but merely because the remedies will make insurors feel better. The idea legislatures are supposed to accept is that if insurors feel better, they might not set nasty rates. The Task Force has pointed out that there is no nexus between legal doctrines held in the various states, the amount of product liability lawsuits filed, or the proportion of plaintiff victories. Nor has evidence been presented that insurance rates vary between states according to the liberality of their legal doctrines. Giving the insurance companies everything they want is unlikely to help manufacturers' premium costs.*

Certainly there are problems with the product liability system which need work in the future, for the benefit of the consumer. First, litigation is at present too expensive to permit any but the most grievous injuries to enter the system. The losses for all the other injuries lie where they fall, regardless of fault, on the injured. Those consumers who do win a case, must pay too much of their recovery for lawyers and experts. Second, much more attention should be paid to improving manufacturing processes, and redesigning products. The Report indicates that there have been improvements in injury prevention

* The only remedy suggested which appears to have a bearing on rates by any objective measure, is prohibition of consumer lawsuits at a certain cutoff time after purchase. While it may be true that manufacturers should not be liable for products which break down after their useful life is done, a flat cutoff will unfairly protect manufacturers who know their products are used for a long time, who promote their products for durability, and manufacturers of products whose injuries have a delayed appearance.

activities in recent years, but a large number of businesses do not have them. Insurance companies should require all insured to initiate prevention activities. Trade associations should do a better job of apprising their members of their legal obligations and developing case law. Finally, it should be realized that commercial product liability insurance is not a societal necessity, and that, in fact, business which do not have such insurance may have a much higher incentive to prevent injury, since the losses will come out of their own pockets.

In a number of state legislatures, insurors and manufacturers are continuing to promote self-serving measures which the Report opposes. For example, at least 12 bills have been introduced in states such as New Jersey, Minnesota, and Washington to make industry custom an absolute defense to a product liability lawsuit; at least ten bills have been introduced to make compliance with government regulations an absolute defense. State legislators are frequently ill-equipped to evaluate industry claims and some mechanism needs to be established by the Task Force to disseminate its findings to the states, where its rational approach is needed at this time.

COMMENTARY ON THE INSURANCE CONSIDERATIONS IN THE FEDERAL INTERAGENCY TASK FORCE REPORT ON PRODUCT LIABILITY

The Interagency Task Force Report on product liability is a significant piece of research, a synthesis of an enormous amount of information from a wide variety of sources concerned with product liability. Moreover, it attempts to describe current practices in product liability insurance, underwriting and rate-making, and brings a welcome emphasis on the potential of industry and insurers to reduce product liability losses through preventive techniques. Our major concerns with the report are those policies which are implicit in the conclusions pertaining to insurance mechanisms.

Unquestionably there is a "credibility" problem connected with product liability insurance in that insurers are not generally believed to have had sufficient reason for the sharp increases in rates imposed over the last two years. In pursuit of that belief the Report concludes that better data should be collected and product rates should be

closely related to correctly assessed product risks. The Report suggests that this might be best accomplished through government regulation and that the thrust of regulation in the product liability field should be directed thereto. Such a conclusion assumes the necessity that a given line of insurance (and within the line itself each individual rate classification) can and should be statistically credible for rate-making purposes and that the packaging of product liability with any of the many other third party lines of insurance is inappropriate. We disagree. Lack of data on a single peril does not necessarily justify establishing large-scale reporting mechanisms with their attendant costs, nor is it a basis for imposing rate regulation in an effort to accomplish what may be actuarially impossible. Here it may be useful to look at analogies to other lines of insurance. For example, the peril of earthquake is an actuarial puzzle and is offered as a separately insured and rated risk only at prohibitively high premiums. When packaged as part of "all-risk" property insurance policies, however, the coverage is generally available at reasonable cost. The same circumstances prevail in the risk of contractual liability which defies the pricing ability of ratemakers and is therefore normally written as part of a comprehensive policy.

Recognizing that the Report's conclusions in this area are not specific recommendations for legislation, it is nonetheless our impression that the Report calls for increased regulation in an area which does not require and is not amenable to rate regulation. In the absence of regulatory action, we expect that rates for product liability insurance will fall. The conclusions of the Report, however, suggest a reporting system which would primarily be of use to regulators and which could lock in permanent place a problem beginning to be solved by the forces of the marketplace.

Continuing its emphasis on regulatory solutions, the Report discusses surplus lines and reinsurance; it is correctly observed that these are both important sources of product liability insurance capacity. However, a fundamental misunderstanding of the actual surplus lines function and its significance in the overall insurance mechanism is apparent when the implication is left that surplus lines ought to be more closely monitored in order to control costs and minimize the risk of insolvency. The concept of surplus lines and in fact the term itself are as unique to the United States as our form of rate regulation. It could be said that the development

of the surplus lines market and its continued existence is a direct reflection of the failure of regulation to accomplish its intended purpose. It is a form of escape hatch or relief valve which allows the system to continue to function in spite of regulation and is tolerated by regulators as such. Rate regulation of surplus lines is a contradiction in terms.

With respect to solvency considerations we would like to make two points: First, the insolvency record of regulated companies is far worse than the record of the surplus lines market. Second, the prospect of insolvency should be considered primarily from the standpoint of the policyholder rather than the accident victim. To our knowledge no claimant in a product liability case has failed to collect his loss due to the insolvency of the defendant's insurer, and no one has suggested compulsory product liability insurance for the benefit of accident victims. A self-insurer is not required to show evidence of financial responsibility and so long as this is the case there is no apparent reason that the solvency of a product liability insurer should be the subject of regulation for the benefit of interests not a party to the insurance contract itself.

Several details of the Report are especially worthy of comment:

1. The discussion of "claims-made" liability insurance forms of coverage is very misleading. The "claims-made" form of liability policy is useful in certain types of insurance, principally professional indemnity coverage, but it is potentially dangerous to the buyer of product liability, especially if he does not understand fully its limitations. The real problem with "claims-made" in product liability is that it will occasionally put the buyer in a position of in effect having to insure his house when it is already burning. There are other better ways to shorten the underwriting tail and reduce the speculation in product rate-making: To cite one, the definition of "occurrence" can be tied to the date when injury is first manifest.

2. The Report says (Chap. V, Pg.12, lines 617-20) "To be statistically sound, rates for each product class should be based on the claims experience per unit of exposure that has occurred in the past. That is, assessments

of the probability of claims in the future for a given class should be based on knowledge of claims in the past." This is a decidedly arguable point which ought not to be made as a statement of fact. For example, a growing number of rating experts is exploring the possibility that environmental or exposure rating techniques are more valid in product liability rate-making than the mere extrapolation of loss experience. It would have been preferable to see the Report speak to the point that for product rating to be statistically sound, it is necessary to achieve technological improvements in underwriting techniques and the industry should be encouraged to devote the effort and expense necessary to accomplish this end.

3. There is a discussion (Chap. V, Pg. 38, lines 1798-1805) of the possibility that the IBNR techniques of insurers and reinsurers may be working to create a pyramid effect on reserves and hence on product liability rates. It is perhaps more than anything else a testament to the complexity

of the insurance business that the Task Force could reach such conclusions. There may or may not be a pyramid effect in product liability rating but if there is it is due to other causes. By way of illustration, insurers and reinsurers both may set case reserves for individual claims and though the primary insurer's reserve may include amounts recoverable from reinsurers, no one suggests that the effect of the reinsurers' reserves leads to rate redundancy.

4. In the discussion of federal reinsurance (Chap. VII, Pg. 101, lines 5127-5129) there is the suggestion that retrospective rating and full credit for investment income generated by reserves might limit the amount of the subsidy inherent in the federal reinsurance proposal. The long tail in product liability and the essential need for conservatism in the rating thereof (from solvency considerations alone) are factors which make retrospective rating and credit for investment income highly desirable facets of any rate-making scheme, not only federal insurance. These concepts are increasingly adopted by

product liability underwriters today and it should also be noted that the idea of group captive insurance companies and structured self-insurance plans are both essentially adaptations of the idea that equitable pricing of long tail risks requires giving insureds a stake in investment income generated by the premium and in any adjustment of the overall cost dictated by the claims experience which is eventually developed. (Not obvious in the Report or its conclusions, is the evidence that society is suffering from the problem of availability and affordability and that governmental initiative is needed.)

5. The Report (Chap. VII, Pg. 109, lines 5504-5518) quotes and appears to endorse a statement to the effect that the practice of underwriting selection is unique to insurance and, furthermore, not in the best interest of insureds. The first part of this statement is incorrect, (e.g., selective underwriting is fundamental to the credit side of banking and other forms of lending). The second is highly arguable -- selective underwriting is

inherent to classes of insurance that are generally available as well as those which have a residual market problem. Many factors can lead to the unavailability of a given line of insurance, but "selection" is not one of them.

6. We commend the Task Force for its generally favorable position with respect to the encouragement of captive insurance companies, including association captives. However, the conclusions with respect to individual-owner captives reflect a possible misunderstanding of their function. The Report says (Chap. VII, Pg. 127, lines 6253-6260) that such captives could lead to increased insurance costs because they lack the pooling of risk common to other insurance ventures. The main point of a single-owner captive is to provide a means of funding and administering that portion of the owner's risk which he is able to absorb himself and does not need to transfer to a conventional insurer. To the extent that the use of captives is inhibited by regulatory and federal income tax considerations, risks are transferred to the

conventional insurance market unnecessarily. This results in a wasteful increase of demand on an insurance market which already suffers from limited capacity. Furthermore, it is demonstrable that captives lead to a reduction of the overall cost of insurance, not an increase.

The Report also suggests that an inadequately capitalized single-owner captive may not be able to compensate claimants. In addition to noting again that there is no demand for compulsory product liability coverage, we would point out that the risk of insolvency is immaterial to the policyholder when he is the sole owner of an insurer in which he has placed risks he has chosen not to transfer to the conventional market.

7. The Report recognizes the potential value of structured self-insurance programs (Chap. VII, Pg. 135) but expresses concern over their potential impact on federal tax revenue and about the prospect of giving special treatment in the tax code to product liability. With respect to the tax impact, there is reason to

believe that the deductibility of payments to structured self-insurance programs can lead to an increase in revenue. Experience has proven to our satisifaction that much insurance is purchased purely for tax reasons; this is particularly true in the case of "long tail" business where an insured can take tax deductions for premiums years before he could acknowledge an uninsured loss. On the other hand, the amount contributed to a self-insurance fund should consistently average in the area of 25% less than the amount necessary to secure conventional insurance for an equivalent risk. Since the deductibility of such contributions would lead to a significant increase in the practice of self-insurance and a corresponding decrease in the purchase of conventional insurance, it is argued that the result would be an increase in corporate profits and, therefore, corporate taxes. This would obviously be offset, but only partially, by a reduction in corporate tax revenue where credit is given for risks already self-insured. As for the

argument recited in the Report that adverse contingencies should be funded with pre-tax dollars, we would like to make the point in support thereof that insurance companies are permitted to fund such contingencies with pre-tax dollars and the denial of a similar right to non-insurance companies could be viewed as discriminatory or, in effect, a form of federal subsidy of the insurance industry.

****

A general impression of the conclusions of the Study is that they seem to place undue faith in residual market mechanisms as a solution to the product liability availability and cost problem. We agree with the Task Force's caveat that the provision of such markets has serious policy implications, but we do not agree that such markets are rooted in practicality. There is unsatisfactory evidence that such mechanisms are practical. They have not worked, voluntary or compulsory. If such mechanisms are effected, public subsidies can become subsidies to the production of unsafe products, and could tend to be triggered by political considerations more than underwriting and market considerations. It is also historically true that no matter with what good faith

they may be initiated on a temporary basis, they inevitably become permanent institutions with a tendency to perpetuate, if not compound, the problem they were designed to solve. The study is unequivocally correct in noting there is a lack of specific data about the effectiveness of such mechanisms. There is ample evidence about their ineffectiveness, however.

The Task Force is to be commended for taking a balanced view of the product liability problem. We believe that a number of factors are at work which can improve the situation with respect to the availability and also the cost of insurance. Among those we would include the increasing use of single-owner and association captive insurance companies, the generally impressive current profitability of traditional insurance companies and the accelerating influx of foreign investment through the entry of foreign carriers in the domestic market. Each of these developments represents an encouraging new form of additional insurance capacity and the effect thereof is inevitably favorable in terms of availability as well as affordability.

Robert Clements

RC:ut

November 10, 1977

SEARS, ROEBUCK AND CO.

Comments on Final Draft Report

of Interagency Task Force

on Products Liability

The Report provides a diligent and admirable study of both products liability issues and a variety of advocated changes in our socio-legal mechanisms which deal with product related injuries.

It is clear that few of the advocated changes have much chance of early enactment (at least at the Federal level), because of insufficient hard data to support them. It is reasonable to expect that product related injuries will continue to be the subject of litigation, with the courts as the ultimate decision-maker in assessing responsibility for such accidents. As this is true, it is incumbent upon those concerned with products liability issues to sift through the changes advocated for the tort law system and determine which of them, alone or in combination, offers any realistic hope of alleviating some of the problems besetting manufacturers and insurers, while preserving the right of consumers and workers to secure redress for injuries caused by unreasonably unsafe products.

I.

The pre-eminent objective of the Restatement, § 402A, was to protect the American consumer from the "lemon"; that is, a mass-produced product

subjected to shoddy workmanship or made fallible through the use of inadequate materials. The Restatement excuses the injured plaintiff from developing proof of specific negligence during the manufacture of such products, and allows recovery where the product is defective, no matter how thorough the manufacturer may have been in its quality control procedures. The Restatement recognizes that even the most careful manufacturer can put out a "lemon", and adopts the value judgment that all consumers, through the seller, should bear the loss of any injury, rather than the individual consumer.

Courts have expanded the concept of "product defect" to an unrealistic and unworkable extent, as evidenced by the Report's discussion of a number of areas of tort law which have become fundamentally unfair or excessively burdensome to manufacturers and other sellers. Some of these specific areas include liability for ancient products; the use and extent of a "state-of-the-art" defense; the "foreseeable misuse" doctrine; and the application of hindsight through the testimony of hired expert witnesses. All of these subjects are further cloaked with the unpredictability and inconsistency arising from the variety of case law generated by fifty State jurisdictions. It can be argued that some of these extensions put the seller and manufacturer in the position of insuring against any injury.

Most of the manufacturers' legitimate complaints in these areas would be put to rest by the adoption of a Federal statute of limitations

and/or uniform State laws which would bar products liability claims five years after the date of manufacture, except those based on express written warranty or a defect in workmanship or materials.

This proposal would retain the manufacturer's current "wide open" liability exposure for the first five years of a product's life. Claims based on design, warnings, advertising, instructions, foreseeability, testing, etc., would be barred after five years. Component manufacturers should remain liable for defective parts incorporated in the finished products of others, in appropriate cases. Although under this proposal, a component manufacturer might not be sued directly by the consumer, he should remain vulnerable to claims for indemnity or contribution.

Viewed in light of Chapter VII's six basic considerations for evaluating tort law changes, this proposal has much to offer and suffers few of the infirmities of other advocated changes.

1. Ensuring Reasonable Compensation for Parties Hurt by Unreasonably Unsafe Products

   A seller remains fully liable for construction (workmanship and materials) defects for the life of the product. Such liability presents no conceptual problem and is a risk manufacturers and insurers are capable of bearing (p-VII-13).

   Retaining life-time exposure for construction defects avoids

the useful life debate, leaving that issue to be a factor in individual cases, in determining whether a product was defective when made or whether its failure was due simply to wearing out with the passage of time.

Cutting off other causes of action after five years admittedly may deprive some plaintiffs of recovery, where no construction defect in the product is demonstrable. However, the vast majority of product claims appear to arise within five years of the distribution of the product (p-VII-16). Any true or serious design or mislabeling defects in all types of product almost always will manifest themselves within five years.

The activities of OSHA, CPSC and private standards-making groups are having an increasing influence on manufacturers' choice of designs and materials. It is becoming less likely that poor designs will be marketed, or, if they are, that they will survive more than five years on the market without government intervention.

This proposal would not require any changes in the basic tort law system or impair any of its legitimate aims. Its adoption would eliminate or significantly reduce the "horror stories" in the present system. It does not seem unfair to limit a manufacturer's responsibility for design, warnings and foreseeable use to a full five years into the future. Often design and warning complaints are efforts to excuse an obvious misuse of a product

in the guise of a "foreseeable misuse". The imposition of design liability years and years after a product is made essentially makes a manufacturer an insurer against all injury, and it is this burden which appears most inequitable (and difficult to insure) under the present system. When a manufacturer is held liable for a design that is long superseded by technical progress, there is no therapeutic effect on the people designing products today. This is especially true in the case of workplace machines that have been reworked, altered and modified over the years.

Under this proposal, the States will continue to establish policies regarding essentially local matters such as attorneys' fee arrangements, the nature of damages recoverable, and the treatment of the relative rights of employers, workers' compensation insurers and third party manufacturers. Any changes in these areas should be made on the basis of their impact on the entire tort system and not on the effect on products liability alone.

2. Ensuring Availability of Insurance to Responsible Manufacturers.

The proposal would not eliminate all uncertainty as to the insured risk on older products, but would eliminate a significant part of it. The effect on rate-making of such a limitation is not clear, but it would tend to make insurance more available to the manufacturing sectors most affected by the present situation.

The proposal would enable insurers to take a hard look at the design and production skills of current or potential customers and give favorable rates to those putting out good products now, without the spectre of untold liability risk on products designed technical generations in the past.

3. Placing Incentives for Risk Prevention on the Party Best Able to Accomplish that Goal.

The incentives for marketing safe products will not be affected by this proposal as the manufacturer will have his present exposure for five years. Adherence to the state of the art will still be a compelling interest. Adoption of design and safety innovations will continue to increase as a loss prevention and competitive factor.

In contrast, broadly funded no fault arrangements, if applied to products liability, could reduce manufacturers' incentives. Since the tort system remains a fault-finding mechanism, the continued imposition of a reasonable fault oriented liability may still be the best means devised to date to encourage the production of safe products.

4. Expedited Payment of Reparations.

So long as product liability is still determined by the courts, there is no simple panacea for delay in the processing of claims. Arbitration boards or no fault systems are not clearly

preferable alternatives. In most juridictions, it is possible to bring a claim to trial in 1-2 years. Often, claimants will delay prompt hearings on claims because time must pass before the nature and extent of their injuries can be evaluated. Even in badly back-logged courts, discovery and trial can be accelerated to accommodate plaintiffs whose injuries have left them without income. Special divisions of courts can be created to expedite the hearing of product suits, such as the Circuit Court of Cook County, Illinois, has done in the case of medical malpractice claims.

The limitation proposal, as applied to claims on products older than five years, could have the salutary effect of reducing court burdens by eliminating many of the questionable suits which are less likely to be settled and more likely to entail extensive discovery, motions, trials and appeals. This should help expedite the handling of the remaining cases.

5. Minimizing the Sum of Accident, Prevention and Transaction Costs.

The proposal would have a significant effect in lowering transaction costs in regard to those cases involving older products. Claims and litigation would be less protracted and would not invite the use of costly, hired design experts and the expenditure of attorneys' time in evaluating esoteric design questions.

6. Specificity and Concreteness of Remedy.

The proposed limitation responds to both desired criteria. The limitation should be drawn so as to pre-empt State legislation and may be Constitutionally justified by a finding that the claims and suits to be barred now impose an undue burden on interstate commerce. In addition, the adoption of uniform State legislation incorporating the limitation should be undertaken as a backstop to the proposed Federal measure, and to govern intrastate products liability claims not reached by a Federal enactment.

II.

Some have proposed a no fault system as a means of solving the products liability problem. The Report states that insufficient data are now available to evaluate the effectiveness and cost of a no fault approach. The Report recommends further study in this area. We agree that further study is indicated. However, such study should not be confined solely to the products liability context, but should be related to the on-going legislative dialogue over universal health care or national medical insurance. It is true that catastrophic accidental injuries are too costly for any one individual to bear, but this is true whether or not a defective product caused the injury. The present tort system helps only those who can find a viable defendant and prove liability under the many diverse laws. It is not equipped to help the many others with similar injuries who cannot recover from anyone.

One area of the Report departs from the now well-accepted and rational imposition of product defect losses upon the party ultimately responsible, i.e., the manufacturer. At pp. VII-70, 71, the report endorses "downstream" contribution among manufacturers, distributors and retailers in the stream of commerce. The Report states that the goal of accident prevention "would be more likely to be achieved if contribution claims were allowed among all parties in the manufacturing chain". This statement does not reflect commercial reality. Manufacturers employ the engineers who design products and have sole control over the facilities, materials and processes involved in production. Distributors cannot control defects. Downstream contribution would diminish the manufacturers' dollar incentive to market safe products. Existing law and insurance arrangements already provide a liability exposure for the downstream merchant who, for example, creates a defect by altering or damaging a safe product while it is in his hands. Downstream merchants already have high transaction costs from product liability claims traceable to manufacturers. The downstreamers' incentives the Report speaks of already exist in abundance.

If consistency in the law is valued, there is a further objection to a proposal allowing downstream contribution on the sellers' side of a lawsuit, where the distributor or retailer has not created the defect. Most States adopting strict liability have held, in one way or another, that an injured plaintiff is not barred from recovery if his alleged contributory "misconduct" consisted merely of failure to discover or remedy a defect in the product. It would be anomalous to hold that a

consumer is innocent in law when he has failed to discover the manufacturers' defect, and yet hold that the manufacturer is entitled to contribution from downstream merchants who likewise have simply failed to discover or remedy the defect. In most cases, the distributor or retailer has no opportunity to discover defects in manufactured goods, either because they come packaged ready-for-sale or because only exhaustive testing and use of products can disclose latent defects. Design and testing of goods are and should remain primary responsibilities of manufacturers, who know their products best and have the best opportunity to enforce quality control. Shifting of defect losses through contribution would dilute those responsibilities.

The adoption of downstream contribution would further aggravate the present uncertainties in products liability insuring practices and would add an inflationary products liability cost factor to the consumers' cost of goods. At present, it is generally understood that manufacturers will bear the ultimate loss for manufactured defects. The insurance cost and availability problems prompting the Task Force study have been manufacturers problems. If downstream contribution is adopted, manufacturers' insurance problems will not go away, but distributors and retailers, relatively unburdened until now, will inherit the same problems that now afflict manufacturers. Downstream contribution would make loss allocation uncertain, requiring all sellers to insure to the hilt with increased cost to the buying public.

ESTABLISHED 1912

The LANNOM MANUFACTURING CO.

TANNERS AND MANUFACTURERS

BASEBALLS

INDOOR, PLAY GROUND & RECREATION BALLS

WE OWN AND OPERATE OUR OWN TANNERY AND WOOLEN MILL

TULLAHOMA, TENNESSEE, 37388

TELEPHONE
AC 615 455-0691

MARTHA LANNOM PARISH
CHAIRMAN OF THE BOARD
JOHN L. PARISH, PRES.
BILL N. KEENE, (CPA)
V. PRES. & TREAS.
W. C. TIPPS, V. PRES. - TANNERY
FRED JUER, PRES.
WORTH BAT CO.
JESS HEALD, VICE PRES.
SALES & MARKETING
R. D. CLAY, VICE PRES.
PAUL CREDLE, V. PRES. - BALL DIV.
W. C. YARBROUGH, V. PRES.
CHARLES DALE, SEC'Y.

November 8, 1977

Mr. Sidney Harmon
Under-Secretary of Commerce
Department of Commerce
Washington, D. C. 20230

Dear Under-Secretary Harmon:

I very much appreciate this opportunity to relate to you my conclusion after studying the Interagency Task Force report on product liability.

The report is very thorough and I believe it has attempted to state all phases of the problem.

Any report of this type can, of necessity, state all phases and possible suggested solutions to the product liability problem it can, of course, be interpreted by different people with different views to make it appear that it supports their position.

I, naturally, view the report from the standpoint of the sporting goods manufacturers, who in most cases, consists of small business. In addition to the fact that we are primarily a group of small businesses, we are, also, in an industry that by its very nature is one in which injuries do occur.

The report does state that small businesses have suffered more by the product liability problem than large business. The reports, also, states that some industries can have higher rate increases that others. Sporting goods industry falls into these categories. I know personally of a number of sporting goods manufacturers that have had their insurance raised to 8% of the selling dollar not the 1% averaged out in the report. I am sure that you will agree that averages are very misleading. There are, also, a number of sporting goods manufacturers who have been unable to obtain insurance because it is unaffordable.

A very alarming statement in the report is that perhaps the legislature should study the social economic aspects of business that might be phased out because of high cost of insurance. The decision to let businesses go down the drain has already cost the American people a great number of jobs.

WORTH-another name for VALUE

I attended the recent meeting of the small business administration in which it was stated that 47% of the work force in the country works for small business. I certainly do not believe it is the intent of the United States government, certainly not of the Department of Commerce, to allow 47% of the work force in this country to be put out of work on a small fragmentary piece-mill basis. The report did state that this is not a decision or area to be covered by the report, but, of course, it is one of the items that alarm my industry very much. A great share of the sporting goods industry has already been exported to foreign countries and we have become importers of the products. It certainly would seem that it is to the advantage of our country, even in the small amount of dollars involved in the sporting goods industry, to keep the employment in this country and not further hurt our balance of payments.

Our industry, also, is not in favor of government subsidy in the form of reinsurance or other methods to give a temprary solution to the problem.

Among the solutions mentioned in the report, is a revision of the Tort Law on the Federal level to return to manufacturers some reasonable defenses. The reason for requesting a federal level rather than state level as most manufacturers operate throughout the fifty states and uniform laws are certainly necessary. We are requesting that Congress return to its position as a legislative body of making law allowing the courts to administer law. The problem has occured with the courts making law through very liberal interpretations.

For the record, I do wish to state that no one in our industry is seeking to prevent any injured party from his or her just, legal right to recovery in the event of injury if a product is truly the cause of the accident. We do feel that the manufacturers and sellers of products should be returned our constitutional rights to being innocent until proven guilty and not to be responsible for things beyond our control in the use and misuse of products. A manufacturer who makes products that are not defective when they leave his custody and that are designed with the best of all knowledge available at the time of manufacture and products that have performed for a reasonable expected life, depending on the use and construction of the product, should be able to use these facts as a legitimate defense.

If action is not taken on a federal level many small manufacturers will go out of business and as stated in the report many small manufacturers will be obsorbed by larger business who can afford insurance and the costs as they have a broader base over which to spread the cost. I believe that you will agree it is not in the best interest of the country to have this type of thing happen.

I respectively request that in the final copy of this report or release of this report by the task force more emphasis will be placed on the affects of the product liability problem and its possible remedies on the small business community.

Yours very truly,

WORTH BAT COMPANY

Frederick Juer
President

FJ:jb

WHITIN-ROBERTS COMPANY
POST OFFICE BOX 1889
CHARLOTTE, NORTH CAROLINA 28233

EUGENE M. KENNEDY
PRESIDENT
SALES DIVISION

November 14, 1977

Mr. Edward T. Barrett
Project Director
Interagency Task Force
on Product Liability
United States Department of Commerce
Washington, D. C.

Dear Mr. Barrett:

Concerning the Final Report, October 31, 1977, Interagency Task Force on product liability: I am encouraged that it offers support to capital goods manufacturers dire need for relief. Specifically, the report indicates there should "be given high priority for further development and evaluation" of workers' compensation as sole source remedy. I agree.

The Textile Machinery Industry and other capital goods associations are presently adding to existing conclusive data to support this approach which should be legislated. One of the increasingly clear and severe trends is that the percent of sales/insurance rate ratio has risen since the December 1976 base cited by the report.

Congratulations for compiling such a fine document.

Yours sincerely,

EMK:pg

Our Diamond Jubilee Year 1902-1977

national machine tool builders association

7901 WESTPARK DRIVE
McLEAN, VIRGINIA 22101
AREA CODE (703) 893-2900
TWX 710-831-0031 NMTBA MCLN

CHAIRMAN AND
CHIEF EXECUTIVE OFFICER
PHILIP R. MARSILIUS
EXECUTIVE VICE PRESIDENT
THE PRODUCTO MACHINE COMPANY
BRIDGEPORT CONNECTICUT

1ST VICE CHAIRMAN
THOMAS R. RUDEL
CHAIRMAN OF THE BOARD
THE V&O PRESS COMPANY INC
NEW YORK NEW YORK

2ND VICE CHAIRMAN
RUSSELL A. HEDDEN
PRESIDENT & CHIEF EXECUTIVE OFFICER
KEARNEY & TRECKER CORPORATION
MILWAUKEE WISCONSIN

TREASURER
JAMES L. KOONTZ
GROUP VICE PRESIDENT–MACHINE TOOLS
EX-CELL-O CORPORATION
TROY MICHIGAN

SECRETARY
NORMAN L. DUNLAP
EXECUTIVE VICE PRESIDENT
THE MINSTER MACHINE COMPANY
MINSTER OHIO

DIRECTORS

W. PAUL COOPER
PRESIDENT & CHIEF EXECUTIVE OFFICER
ACME CLEVELAND CORPORATION
CLEVELAND OHIO

WILLIAM L. DOLLE, JR.
PRESIDENT
THE LODGE & SHIPLEY COMPANY
CINCINNATI OHIO

NATHANIEL B. HOWE
VICE PRESIDENT–LITTON INDUSTRIES INC
PRESIDENT–NEW BRITAIN MACHINE DIVISION
NEW BRITAIN CONNECTICUT

D. S. JONES
PRESIDENT–INDUSTRIAL/ENERGY GROUP
THE BENDIX CORPORATION
SOUTHFIELD MICHIGAN

HAL P. KIBBEY
EXECUTIVE VICE PRESIDENT
E. W. BLISS DIVISION
GULF + WESTERN MANUFACTURING COMPANY
SOUTHFIELD MICHIGAN

M. L. WILKIE
PRESIDENT
DoALL COMPANY
DES PLAINES ILLINOIS

W. E. ZAHN
PRESIDENT
NATIONAL MACHINERY CO
TIFFIN OHIO

EX-OFFICIO:

RALPH E. CROSS
PRESIDENT
THE CROSS COMPANY
FRASER MICHIGAN

J. B. PERKINS
CHAIRMAN OF THE BOARD
THE HILL ACME COMPANY
CLEVELAND OHIO

STAFF

JAMES A. GRAY
PRESIDENT

ELWOOD H. HASEMANN
ADMINISTRATIVE DIRECTOR

LEONARD ABRAMS
EXHIBITION DIRECTOR

EDWARD J. LOEFFLER
TECHNICAL DIRECTOR

WILLIAM ATKINSON, JR.
SAFETY DIRECTOR

JAMES H. MACK
PUBLIC AFFAIRS DIRECTOR

JOHN A. CONNOR
INTERNATIONAL TRADE DIRECTOR

JESSE MAFFUID
INTERNATIONAL MARKETING DIRECTOR

JOHN MANDL
TRAINING DIRECTOR

CHARLES POLLOCK
PUBLIC RELATIONS DIRECTOR

ROBERT A. GALE
STATISTICAL DIRECTOR

FRANCIS MASON
CONTROLLER

October 21, 1977

The Honorable Sidney Harman
Undersecretary of Commerce
U. S. Department of Commerce
Washington, D. C. 20230

RE: Final Report of the Federal Interagency Task Force on Product Liability

Dear Mr. Secretary:

As a member of the advisory committee of the Federal Interagency Task Force on Product Liability, I appreciate your giving me the opportunity to comment on the factual statements and the conclusions or opinions expressed in the Final Report. I have enjoyed working with you and the staff of the Task Force as well as the other advisory committee members in putting together this report on the increasingly serious product liability problem. While some questions remain unanswered, the assemblage of facts and the discussion of remedies in the report offer a helpful basis from which to proceed in the search for a solution to the product liability problem.

The Final Report is, when taken as a whole, an objective and well-balanced presentation of the product liability problem and various remedies. Although members of the advisory committee and of the community at large might quarrel with particular points of emphasis (or lack thereof), no fair observer or commentator can fail to commend the report's fairness. Nor can one fail to recognize the willingness of the report to achieve compromises in the tangle of legal, socio-economic and political issues which encompass the product liability problem.

It is in this spirit of compromise that I was particularly pleased that the report supports the concept of increased Workers' Compensation benefits as an injured worker's sole exclusive remedy against third parties as well as against his or her own employer.

In my memorandum of June 10, 1977 to Ted Barrett, I set forth in detail the factual, legal, and social considerations upon which underlie the conclusion of many observers including the Final Report that the fairest solution to the workplace product liability problem is to make increased Workers' Compensation benefits the sole and exclusive remedy for workplace injuries. I have attached a copy of that memorandum to this letter and incorporate it herein by reference.

While some doubts have been raised as to the severity of the product liability problem in the consumer products area, I believe the facts which have been developed by the Task Force clearly establish that the product liability problem in the workplace is fast reaching crisis proportions. The cost of product liability insurance coverage has risen dramatically since 1970. The range of annual increases in the last two years was 20 to 287 percent, in contrast to a range of 0 to 123 percent in the period from 1970 - 1974. The number of firms with deductibles has increased between 1971 and 1976 by 80 percent for large firms, 130 percent for medium firms, and 100 percent for small firms. Some companies have been unable to attain product liability insurance either because they cannot afford the high cost of premiums or because they cannot obtain coverage at any price.

In the most recent study conducted by the National Machine Tool Builders Association, it was found that the average machine tool builder has seen his product liability insurance costs rise from $10,000 in 1970 to $40,000 in 1975 to $71,000 in 1976 and then almost double again to $132,100 this year. This pattern is typical, even among manufacturers who have never lost a law suit and who have no claims pending. The average metal-cutting machinery builder saw his premiums jump from $1,900 in 1970 to $126,800 in 1977. That is a 6,673 percent increase in just seven years.

In a recent survey conducted by Iron Age Magazine it was found that 54 percent of the respondents believed products liability is indeed a threat to the financial health of their companies. It found that product liability insurance premiums had gone up on an average of 424 percent over the last year, and 657 percent since 1975. One out of three companies which responded to the Iron Age survey had been sued on a products liability claim.

The results of a survey conducted by the Insurance Service Office (I.S.O.) revealed that 42 percent of the dollars paid out by insurance companies on all product liability claims are expended on claims arising out of workplace incidents despite the fact that these workplace injuries represent only 11 percent of the total number of product liability claims. In an analysis conducted by the American Mutual Insurance Alliance (A.M.I.A.) of 79 large-loss claims, it was found that "nearly three-fourths of the awards (70%) involved industrial products, and 60 percent of the 104

NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION · 7901 Westpark Drive, McLean, Virginia 22101 · (703) 893-2900

injured persons sustained bodily injuries while at work. Given this dominant pattern or workplace product liability injuries, it is not surprising to read the reports of large increases in product liability insurance costs, limited coverage, rising claims, and large court judgments on product liability suits arising out of the workplace.

The trends are ominous. Product liability insurance premiums have increased dramatically over the last six years and the prospects are that they will continue to double or triple. Just today I spoke with one of our members who indicated that although he has only two claims pending and has never lost a case in the courtroom, his product liability insurance premiums will increase from $45,000 in 1977 to $450,000 in 1978. Those companies who have deductibles are being asked to retain an ever increasing portion of their liability. The capacity of the insurance industry to cover the product liability exposure of American business has shrunk to the extent that substantial numbers of businesses can either not afford to pay the premiums for available insurance, or they are unable to buy product liability insurance at any price.

While these statistics developed by the Task Force substantiate the contention of the Journal of Commerce that there "is a product liability mess" (if not a crisis) in the workplace, it is equally clear that the system of compensating people who are injured in the workplace is extremely unfair and wasteful, and that the wrong party is paying the bill for this wasteful system.

The Final Report recognizes the inequity of the present system of compensating many victims of workplace injuries. Under present law virtually every state Workers' Compensation statute (and/or its court interpretation) bars recovery or indemnification from the employer by a product manufacturer, no matter how negligent the employer may have been in failing to properly guard and maintain the product or in failing to properly instruct and monitor his employees on how to use the product. This inequity is further compounded by the fact that, in most jurisdictions, the employer and/or his Workers' Compensation insurance carrier has a subrogation lien against third party recoveries even though the employer may have caused or contributed to the cause of the employee's injury. The recently released I.S.O. Study reveals that about 24 percent of product liability bodily injury payment dollars are expended in cases involving possible employer negligence. This means that over 57 percent of the dollars paid out for workplace injuries involve cases in which the party who caused the accident gets off scott free. Thus manufacturers of workplace products are, in effect, paying the entire cost of many industrial accidents, while users of the product are completely relieved of financial responsibility even though they may have been in a better position to prevent the accident from occurring.

NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION · 7901 Westpark Drive, McLean, Virginia 22101 · (703) 893-2900

The Final Report recognizes that the workplace product liability problem is inextricably interwoven with the inequities and injustices inherent in the Workers' Compensation system. I am pleased with the conclusion of the Final Report that "the cost effectiveness and potential impact of the Workers' Compensation sole source remedy make it an attractive one for serious legislative consideration. It would appear that it should be considered along with more general workers' compensation legislative reform." That conclusion is supported by the Industry Study which stated that "the use of the Workers' Compensation system assures compensation to the injured parties, minimizes the total sum of accident cost, places incentives on the party best able to implement preventive programs, and expedites the reparations process." The Insurance Study makes the same recommendation.

Although many industrial product manufacturers and suppliers would question whether the recommended third party contribution to the Workers' Compensation system or post accident arbitration proceeding is needed as an incentive to product manufacturers to improve the safety of products, most would be willing to accept such a compromise as an alternative to the clearly inequitable and costly system currently in operation.

The forum for the arbitration proceeding might well be the state Workers' Compensation agency and should allow an employer or Workers' Compensation insurance carrier which shall have paid or is obligated to pay compensation benefits to assert that a third party has caused or contributed to the cause of the employee's injury for which such obligation to pay compensation benefits existed. The recovery would be limited to the total amount of the compensation benefits obligation. Because the employer is required to proceed under traditional negligence theories, the employer would have to be confident of his own lack of fault before he would incur the expense of an arbitration proceeding against the third party product manufacturer or supplier.

If the Workers' Compensation exclusive remedy approach is adopted, the American working men and women will benefit by the raising of state Workers' Compensation benefits standards to a Federal minimum level and they would be sacrificing only a minimal chance of receiving a substantial award in excess of Workers' Compensation. The facts developed by the Industry Study and which are discussed in the attached memorandum, indicate that only one-half of one percent of product-related work injury claims ever mature into a recovery substantially in excess of Workers' Compensation benefits. From the standpoint of public policy, the American working men and women would benefit more by this compromise proposal than under the present system. The worker would avoid having to pay 25 to 40 percent of his award to plaintiff's attorney and the uncertainty, delay and mental anguish suffered during tort litigation would be eliminated. The exclusive remedy provision would preclude third party law suits from arising

NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION · 7901 Westpark Drive, McLean, Virginia 22101 · (703) 893-2900

out of workplace injuries thereby eliminating the costs of litigation for all parties and reducing the dollars paid out for product liability claims throughout the country by approximately one-half. The negligent employer will become more responsible because his rights to subrogation would be eliminated thereby creating an economic incentive for maintaining a safe workplace. The manufacturer would retain its incentive to develop safe products because of its potential exposure to an arbitration proceeding with the employer for the amount of the Workers' Compensation award.

I believe the Final Report establishes a strong case for Workers' Compensation being the exclusive remedy for all injuries occurring in the workplace. It is particularly timely because the United States Congress will be considering reform of the Workers' Compensation system next year and groups such as the Special Committee for Workplace Product Liability Reform will be urging Congress to include the exclusive remedy in the reform legislation.

I would also like to comment on the assertion in the Final Report that "we are unable to prove that subrogation rights are of special importance in generating product liability suits." The A.M.I.A. Study cited by Report does not rebut the suspicion of some manufacturers and their trade associations that a substantial number of third party law suits were directly fostered by Worker Compensation carriers or by employers asserting subrogation rights.

The A.M.I.A. Study deals only with "large-loss" claims resolving payments in excess of $100,000. Obviously, the Workers' Compensation subrogation liens are an insignificant portion of such "large loss" claims. But those claims are in the minority. As the study points out, 95 percent of all plaintiff recoveries involve out of court settlements. Our own data suggest that these out of court settlements are for an amount somewhere in this neighborhood of the subrogation lien. Further study is needed in order to resolve this question.

Now that the Final Report has been completed and will soon be issued I look forward to working with you, your colleagues at the Department of Commerce, other representatives of American business, and the United States Congress in order to achieve legislative relief for the product liability crisis which is

NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION · 7901 Westpark Drive, McLean, Virginia 22101 · (703) 893-2900

threatening the financial viability of many American businesses and the future of our economy.

Very truly yours,

James H. Nack

JHM:dr

Enclosure

NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION · 7901 Westpark Drive, McLean, Virginia 22101 · (703) 893-2900

June 10, 1977

MEMORANDUM

TO: Ted Barrett

FROM: James Mack

RE: Federal Workers Compensation as the Exclusive Remedy for Workplace Product Liability Injuries

I appreciate your giving me the opportunity to present my comments regarding the content of the final report of the Interagency Task Force on Product Liability. After reviewing the various studies conducted on behalf of the Task Force and based upon my own continuing study and analysis of the product liability problem, I urge you to recommend that the Task Force support the concept of workers compensation being the exclusive remedy for workplace injuries.

It is my belief that the facts which have been developed through the efforts of the Interagency Task Force on Product Liability and the studies prepared by outside contractors corroborate the crisis nature of the product liability problem in the workplace. In the briefing report issued by the Task Force in January, 1977, it found that product liability insurance premiums appeared to have risen substantially for manufacturers who have workplace product liability exposure. Some companies have been unable to attain product liability insurance either because they cannot afford the high cost of premiums, or because they cannot obtain coverage at any price. A number of companies, large and small, are therefore going without product liability insurance.

The results of a survey conducted by the Insurance Service Organization (ISO) reveals that, while 11 percent of the total product liability claims arise out of workplace incidents, approximately half the dollars paid out by insurance companies to plaintiffs, attorneys, and other insurance companies are expended on claims arising out of workplace incidents. In testimony before the Small Business Committee of the U. S. House of Representatives, ISO stated that the average product liability defense cost to the

insurance industry amounts to 42 percent of the total awards made to product liability plaintiffs. For every one dollar that the insurance industry pays out on product liability claims, it has spent another 42¢ defending those claims.

In the final report of the Industry Study conducted for the Interagency Task Force a most convincing case is presented for the need for an immediate solution to the workplace product liability crisis. It reviews an analysis conducted by the American Mutual Insurance Alliance of 79 large-loss claims which found that "nearly three-fourths of the awards (70%) involved industrial products, and 60% of the 104 injured persons sustained bodily injuries while at work." Vol. 1, p. VI-10. The Industry Study also points out that "firms of small and medium size are more likely to have claims experience if they are engaged in the manufacturing of workplace machinery or equipment rather than consumer goods or "anonymous" products." Vol. 1, p. IV-76. Given this dominant pattern of workplace product liability injuries, it is not surprising to read the reports of large increases in product liability insurance costs, limits of coverage, rising claims and large court judgments in product liability suits arising out of the workplace.

The Industry Study indicates that the cost of product liability insurance coverage has risen dramatically, from two to six times since 1970. "The range of annual increases in the last two years was from 22 to 287 percent, in contrast to a range of 0 to 123 percent in the period from 1970 - 1974." Vol. 1, p. I-6. In the most recent survey conducted by the National Machine Tool Builders Association, it was found that the average machine tool builder has seen his product liability insurance costs rise from $10,000 in 1970 to $40,000 in 1975 to $71,000 in 1976 and then almost double again to $132,100 this year. This pattern is typical, even among members who have never lost a law suit and who have no claims pending. The average metal-cutting machinery builder saw his premiums jump from $1900 in 1970 to $126,800 in 1977. That is a 6,673 percent increase in just seven years.

The Industry Study also found "that the number of firms with deductibles has increased between 1971 and 1976 by 80 percent for large firms, 130 percent for medium firms, and 100 percent for small firms. The average deductible or self insurance retention level increased by about 500 percent in large firms, 110 percent in medium firms, and decreased 44 percent in small firms. Smaller and medium sized firms assumed the total risk for product liability more frequently than large firms: In 1976, 29 percent of small firms had no product liability coverage; 13 percent of medium sized firms had no coverage; while only 3 percent of the large firms were insured." Vol. 1, p. I-7. The average number of pending claims per firm has also increased nearly six times and the average amount of damages sought per firm in new claims rose from $476,000 in 1971 to $1.7 million in 1976.

While these statistics establish the fact that there is a product liability crisis in the workplace, it is equally clear that the present system of compensating people who are injured in the workplace is extremely unfair and wasteful, and that the wrong guy is paying the bill for this wasteful system.

Under present law, virtually every state Workers Compensation statute (and/or its court interpretation) bars recovery or indemnification from the employer by an equipment builder, no matter how negligent the employer may have been in failing to properly guard and maintain the machinery or in failing to properly instruct and monitor his employees on how to use the machinery. The costs and damages of product liability suits arising out of workplace accidents are therefore bourne by the manufacturer alone because, not only must he pay damages to the injured worker, but he must also typically pay the subrogated claims of workers compensation carriers. The present court system is inequitable in that the manufacturer is forced to bear the entire burden of liability even though other parties, particularly the employers, may have been partly at fault. Thus, the capital equipment industries are, in effect, paying the entire cost of many industrial accidents, while

many users of the equipment are completely relieved of financial responsibility. Subrogation actions relieve the users of even the impact of workers' compensation awards, which in many states are less than adequate.

In the 1976 survey of the National Machine Tool Builders Association, it was found that in only 13 percent of the workplace product related accidents a case could have been made for some sort of mechanical failure of the machine itself. Almost half of the machines involved were over twenty years old, many of them having been sold, resold, junked, resurrected from the junk yard, and placed in operation in the plant of the employer of the person who was unfortunate enough to get himself or herself permanently maimed. Most of the machines have been modified one or more times by the employer and/or the person or persons he bought the machine from. The study shows that 18 percent of these machines were poorly maintained by the employer.

Sixty-three percent of the time, the accident occurred because the employer failed to properly guard the machine. Thirteen percent of the accidents occurred because he failed to make sure that his employees use the appropriate safety device. Sixty-five percent of the injured employees did not receive appropriate training from their employers on how to properly and safely operate the machine. The NMTBA survey also showed that 58 percent of the employees had been on the job for less than six months prior to injury. What all this adds up to is a situation in which unsafe work practices in unsafe workplaces, maintained by unsafe employers, are causing working men and women to lose fingers and hands, or worse, and the manufacturers are paying for it.

I believe that the product liability problem is inextricably interwoven with the inequities and injustices inherent in the workers' compensation system. Of the four principle potential remedies suggested by the Industry Study, "first and most prominent is the elimination of subrogation and third party litigation under workers' compensation, coupled with the equalization and raising of

state benefit levels. . . . The use of the workers' compensation system "assures compensation to injured parties", minimizes the total sum of accident costs", "places incentives on the parties best able to implement preventive programs", and "expedites the reparations process." Vol. 1, pp. VI-6 and 7. Under this proposal workers would give up certain rights to sue in return for higher, uniform minimum compensation levels for work-related injuries. In operation, this proposal would set federal minumum benefit standards for state-administered workers' compensation programs, and make those benefits the workers' exclusive remedy against the whole world, shutting off the right to sue third parties such as the manufacturers or designers. Subrogation of workers' compensation claims is difficult to justify in the case of a negligent employer and a non-negligent, strictly liable manufacturer. Therefore, the prohibition of subrogation by negligent employers would be desirable. Such a proposal would introduce an economic incentive for employers to provide a safe workplace and at the same time apply the same economic incentive to manufacturers to produce safe products. I believe the analysis conducted in the Industry Study supports this conclusion.

In determining the extent of litigation from workplace injuries under product liability theories, the Industry Study focuses on an analysis conducted by the American Mutual Insurance Alliance and on two surveys conducted by the National Machine Tool Builders Association. In analyzing the NMTBA Survey, the study found that of the 389 resolved claims, "slightly less than one-half (186, or 48 percent) were dropped, while 37 percent were settled out of court at an average settlement amount of $18,000." Vol. 1, p. VI-14. Of all claims, only 15 percent went to trial with 72 percent of those cases found in favor of the defense. Only 4 percent of the total resolved claims ever came to trial and were won by plaintiffs for an amount substantially in excess of the workers' compensation award.

A further factor considered by the Industry Study is the frictional cost such as the expenses of defense and preparation of expert testimony. Its inquiry among affected firms discovered that the average defense cost for workplace product liability claims

was $15,000. The AMIA study found that the average defense cost per case handled was $20,680 and that additional costs for provision of expert testimony averaged $5,888 per claim. Vol. 1, p. VI-14

The Industry Study also analyzed workers' compensation injury reports from a selected body of five states. Product related injuries accounted for one in every ten workers' compensation claims. In approximately one-half of these (or 5 percent of the total), the product involved was a motor vehicle. It is not clear how many of these motor vehicle related injuries involved the potential liaiblity of a third party either in a products liability action against the manufacturer or in a negligence action against the driver. If one were to assume that all of these product related injuries matured into a product liability action and since the study points out that less than 5 percent of all product-related claims are won by plaintiffs at trial, it appears that at best, only one-half of one percent of product-related work injury claims ever mature into a recovery substantially in excess of workers' compensation benefits.

If the workers' compensation exclusive remedy approach is adopted, the American working men and women will benefit by the raising of state workers' compensation benefits standards to a federal minimum level and they would be sacrificing only a minimal chance of receiving a substantial award in excess of workers' compensation benefits. From the standpoint of public policy the American working men and women would benefit more by this compromise proposal than under the present system. The exclusive remedy provision would preclude third party law suits from arising out of workplace injuries and therefore eliminate approximately one-half of the dollars paid out for product liability claims throughout the country. It would eliminate the product liability crisis in the workplace and effect a 50 percent increase in the capacity of insurance companies to offer product liability insurance to the rest of American industry. The negligent employer will become more responsible because his rights to subrogation will be eliminated. However, should the injury be caused by a defect in the product, the non-negligent employer could recover the amount of the

workers' compensation payments from the manufacturer. In this manner, both the employer and the manufacturers will have the economic incentive to maintain a safe workplace and produce a safe product.

If Congress and the Administration decide to go forward with federal minimum standards for workers' compensation, a solution to the workplace product liability crisis should be included in such legislation.

It is my belief that evidence developed by the Task Force leads to only one conclusion: the final report of the Task Force should include a recommendation to the Administration and the Congress that any federal workers' compensation legislation should include a provision making workers' compensation the exclusive remedy for disabilities covered under the act and that the subrogation rights of negligent employers should be eliminated for all workplace injuries, and that passage of such legislation should be accomplished as soon as possible.

INSURANCE SERVICES OFFICE

TWO WORLD TRADE CENTER NEW YORK, N. Y. 10048

TELEPHONE: (212) 938-4622

NIEL J. McNAMARA
PRESIDENT

November 15, 1977

Honorable Sidney Harman
Under Secretary of Commerce
Washington, D. C. 20230

Dear Mr. Harman:

As a member of the Advisory Committee appointed to assist the Commerce Department in its eighteen month study of product liability, I must express my grave disappointment over the extremely short time period given to the Advisory Committee members to review the draft of the Final Report prior to its public release. I know you can appreciate that it was virtually impossible, within such a short time-frame, to comprehensively review and comment on the entire 600-page document on this substantive and complex subject.

As President of Insurance Services Office, I am disturbed that Chapter V, which deals directly with the operation of the insurance mechanism and those functions which are an important part of ISO's responsibility, contains many factual errors, improper statements and/or interpretations that can mislead the reader into improper conclusions. As your associates know, our Washington, D. C. office has already brought to the attention of your office many inaccuracies appearing in the draft report, and we are pleased that many of the errors were corrected. The enclosed memorandum outlines some additional specific areas of concern that remain in the final report, and we would like to have the privilege of discussing these matters further with you or designated members of your staff.

We are confident that individual insurers and/or their trade associations will be submitting to you, in due course, their comments and observations on this report. By copy of this letter, I am urging the President of the three major property-liability trade associations to review this report with special emphasis on its discussion of possible legal remedies, since these proposals concern their areas of responsibility rather than those of Insurance Services Office.

We fully appreciate the complexities involved in product liability and, from the very beginning, we gave our support and cooperation to the study being conducted under the lead of the Commerce Department. We commend the extensive efforts of the staff in putting together this report, which we know will be widely read.

In conclusion, may I once again emphasize that Insurance Services Office is most anxious to cooperate with any efforts to find solutions to the product liability situation. We are most concerned that any future legislative or regulatory activity not be based upon misleading information, errors, or misunderstandings of the

complex technical considerations involved in this line of insurance. Toward that end, I would like to suggest that Mavis A. Walters of our Washington, D.C. office be contacted to aid your Department in its future endeavors in this area.

Sincerely yours,

Daniel J. McNamara
President

enclosure

cc: Mr. Paul S. Wise, President
Alliance of American Insurers
(with enclosure)

Mr. T. Lawrence Jones, President
American Insurance Association
(with enclosure)

Mr. Arthur J. Mertz, President
National Association of Independent Insurers
(with enclosure)

INSURANCE SERVICES OFFICE
INTER-OFFICE CORRESPONDENCE

To: Mr. Daniel J. McNamara — Office: Home/Executive

From: Mavis A. Walters — Office: Washington, D.C.

Subject: Report of Interagency Task Force on Product Liability — Date: November 10, 1977

As you requested, the Actuarial Department has carefully reviewed Chapter V of the report on product liability prepared under the lead of the Commerce Department. Many factual errors were found in the earlier draft and were reported to their staff. Many of those were corrected; a few, however, still remain in the final report.

There are two major weaknesses in the report which clearly result in improper conclusions being drawn.

First, there is little consideration given in the entire discussion to the many substantive changes made over the past several years in the statistical reporting requirements, in the classification plan, in individual risk rating plan procedures and the development of the Commercial Statistical Plan. All of these steps will improve and expand the data base and accomplish most of the things suggested or recommended in the final report.

The second shortcoming is the lack of recognition of the great amount of supplementary material provided to the staff of the Commerce Department during the course of their study. In several places the report refers to no information or lack of evidence on a point when in fact such material was provided by ISO. Specifically, the trend exhibits provided to their staff display the actual increase in product liability claim costs over a 10-year period compared with the increase in the general price level as measured by the Consumer Price Index over that same time period. This is dramatic evidence that product liability claim costs have outstripped inflation. Those exhibits also provide the justification for the factors used in adjusting the closed claim survey data. Information has also been provided on the representativeness of the data in the closed claim study.

Other specific comments and observations on Chapter V of the final report are as follows:

Page V-4, lines 211-2: Coverage is not provided for all product-related damages as is stated in the draft. Rather, coverage is dependent upon liability or negligence. (V-5)

Pages V-5 through V-7 contain an excellent discussion of occurrence policies compared with claims-made policies. (V-6 - V-9)

Page V-8, lines 443-446: This is a very misleading statement. Other rating methods very clearly produce statistically derived rates, i.e., composite rating (when based on manual rates) and loss rating. (V-10, last paragraph)

Page V-9, lines 450, 473, 486: The text quotes the numbers referred to in Table V-3; the comments on that table on page 5 of this memorandum apply. (V-10 - 11)

Page V-10, line 497: This is an incorrect statement. ISO has not requested that composite rating not be used after January 1, 1977. Rather, ISO has filed an amendment to the Composite Rating Plan to eliminate product liability coverage from composite rating after January 1, 1977. (The exception for loss rating is correct.) (V-12)

Page V-10, lines 545-7: There is confusion here. The ISO rate increases occurred in August, 1975 and August, 1976, not December, 1976. The report may be referring to the ISO Circular Letter of January 21, 1977 on suggested (a) rates but it is incorrectly defined as a rate increase. The statement then suggests that increases of this magnitude are likely to occur in the future. This is absolutely incorrect. Not only is it illogical but such a statement is directly contradictory to all of the evidence. The McKinsey study prepared for the Interagency Task Force states exactly the opposite (page ES-4):

> Insofar as recent rate increases appear to represent a correction for past rate inadequacy, it seems unlikely that product liability rates will rise as sharply in the future as they have in the past 2 years.

Furthermore, testimony ISO presented to Congressional committees also indicated that no increases were likely in 1977 and the record shows that ISO did not, in fact, file rate increases for product liability insurance in 1977. (V-13)

Page V-11, lines 550-3: This section attempts to explain the ISO ratemaking procedure, but does so quite poorly. Again, the description is misleading in this context. It leaves the reader with the impression that ratemaking is strictly subjective and judgmental, rather than based on standard credibility theory. (V-13, first paragraph)

Page V-11, lines 556-7: This is another reference to a supposed ISO December, 1976 rate increase over August, 1975 when there is no such animal. This again reflects a lack of understanding of some rather simple facts that were well documented even by the Task Force's own contractor. (V-13, second paragraph)

Page V-11, lines 572-5: Another incorrect statement suggesting further rate increases in the future. (V-13 - 14)

Page V-12, lines 596-604: This section purports to explain the new Commercial Statistical Plan but it is quite garbled and incoherent. The dates are also incorrect. (V-14, third paragraph)

Page V-12, lines 611-20: These paragraphs state that exposures, claims and losses should be obtained to determine overall rate levels and rates by class. It is also stated that rates for each class should depend on the experience of the class. This section actually describes current ISO procedures accurately, and one wonders why it was written in such a way to give the opposite impression. (V-14 - 15)

Page V-12, lines 623-5: This section describes what are believe to be ISO procedures incorrectly. The description is at odds with the McKinsey study, with the ISO Background Report on product liability insurance, with formal testimony made available to the staff, and with the information provided by ISO in a 90-minute briefing session with the Interagency Task Force staff last year. Whether or not rates were adequate to pay losses in the past is not a factor in ISO ratemaking; the methodology for this line of insurance is a premium at present rate analysis using estimates of future losses. (V-15, second paragraph)

Page V-12, lines 627-9: We flatly disagree with this statement. Rates by class are most definitely based upon the actual claims experience within each class. Going further, it can be stated that the ISO procedure is statistically sound since application of credibility factors reduces distortions. (V-15)

Pages V-12 and V-13, lines 631-73: This entire discussion of product liability classes seems to suggest that a classification plan containing fewer classes would result in more "statistically significant" rates. While credibility might be greater for each of the reduced number of classes, the peculiar characteristics of the individual classes that should be preserved would be lost. The resultant rate based on a more heterogeneous class definition could well result in market dislocations. The current ISO ratemaking procedure results in statistically reliable rates by using credibility theory and by applying appropriate weights by hazard groups. The author of this section apparently does not understand that full credibility by class is not necessary to achieve statistical reliability. Additionally, the discussion gives the mistaken impression that ISO rate classes are based on the product codes used in the closed claim survey. (V-15 - 16)

Page V-14, lines 684-9: This section speaks to the desirability of having a reliable data base for establishing rates and determining trends. There can be no argument that a reliable data base is highly desirable; ISO has already implemented the changes and improvements to maximize the data collection and compilation. It is quite misleading to have these statements appear without any reference to the important changes and improvements already in place. (V-16 - 17)

Page V-14, line 706: The statement is made that data related to claims trends are not available. This is not true. ISO has provided such data to the staff of the Interagency Task Force during the course of their study and it appears in public testimony made widely available. (V-17)

Page V-14, lines 711-14: This again states that trends in the severity of product liability claims cannot be determined from available data. This is not true. ISO staff measured claim severity on both a paid and incurred claim basis and provided that information to the Interagency Task Force staff. (V-17)

Page V-16, lines 781-6: This is another reference to premium increases, apparently the basis for earlier statements in the report about the magnitude of future increases. This interpretation fails to recognize that the survey cited merely reflected the effect of the August, 1976 rate increases being felt on renewals. By this time, however, the full effect of the August, 1976 increase and the January, 1977 suggested (a) rates should be realized. (V-19, third paragraph)

Page V-23, lines 1114-20: This section also tends to be misleading. It contains a loss ratio analysis of historical underwriting experience and concludes that further rate increases may be anticipated. The implication is that the increase in rates as calculated here is to be expected in the future. What is more likely is that rate increases have already been implemented, as explained above, and that there will be a levelling off as the McKinsey & Co. study predicted. (V-28)

Page V-24, lines 1154-62: This section is also slightly misleading in that it suggests an arbitrary selection by ISO of what payment amounts would be trended. This was not the case. Every field of data containing economic information was adjusted based on each record submitted to ISO and based on the date of occurrence of each incident. (V-29, last paragraph)

Page V-24, lines 1167-9: We disagree with the implication in this section that trending the data base is not essential in order to make comparisons or draw valid conclusions from the closed claim study. Trend adjustments are used not only as a ratemaking practice but also in any rigorous analysis based on data derived from incidents occurring over a long period of time. It is clear that such incidents reflect different economic values which are a function of the time of occurrence and the distortion in the data resulting from that must be removed. (V-30)

Page V-25, lines 1186-9: This summarizes the trend discussion. While it is true that the untrended data do describe the information for claims already closed, they do not describe that information for claims occurring recently, i.e., even last year. In a very real sense the untrended data base describes a little bit, very little, of what happened last year, a little bit of what happened in 1975, a little from 1974, etc. It does not tell us the effect of everything that happened last year with respect to all these product liability claims; only the adjusted (trended) data base can give us a picture of that. (V-30)

Page V-25, lines 1192-8: This section speaks to the representativeness of the ISO sample and states that it is not known what fraction of the total product liability premium is written by the 23 participating carriers. This is untrue. ISO supplied the Task Force staff with precisely this information. (V-30 - 31)

Page V-25, lines 1203-12: This section mentions two other "deficiencies" in the Preliminary Report. Neither of these "deficiencies" exist in the Final Report. (V-31)

Page V-27, lines 1256-71: This section summarizes some of the earlier discussion and repeats the suggestion that the closed claim study may not be a representative sample. This is despite the evidence presented to the staff. It appears that the writer did not review all of the material submitted by ISO. (V-32 - 33)

The reasonable "assumption made" in lines 1266-8 turns out not to be so reasonable. ISO has run the reports both with and without the Liberty Mutual submissions and that insurer's data do not affect the results.

Pages V-27 and V-28, lines 1283-1293: The conclusion that current methodology is imprecise cannot be disputed. However, the deficiencies in ratemaking procedures and statistical gathering have already been or are about to be corrected. This report does not give much weight to the changes that have been implemented; perhaps this was other evidence somehow overlooked by the author of Chapter V.

With the respect to the ISO closed claim survey, as mentioned earlier,

1. The "deficiencies" of the Preliminary Report do not exist in the Final Report.
2. The ISO Closed Claim Survey does present a representative sample.
3. A continuing closed claim study would not provide any additional information beyond that already provided.
4. Untrended data cannot provide valid information about the current claims environment. One would hope that future decisions would not be based on such misleading information. (V-33)

Page V-38, lines 1798-1804: This discussion reveals a lack of understanding of how rates are made. There is no cumulative effect of IBNR reserves for primary companies and reinsurers because rates are determined on a direct basis. (V-46)

Page V-38: The conclusion section focuses again on lack of data for product liability and again fails to recognize that major steps have already been taken to alleviate this. (V-47)

Page V-39, lines 1873-7: See previous comments on this subject. (V-48)

Page V-40, lines 1909-14: Another discussion of classification plans. Again, current ISO practices are in accordance with the suggestions made here. (V-49)

Page V-41, lines 1929-32: The statement is made that state regulators should have a countrywide data base to evaluate rate requests effectively. Since ISO reviews product liability experience on a countrywide basis, that material is filed with insurance departments. They have it and will continue to get it. (V-49)

Table V-3: The presentation of this distribution of product liability premium is incorrect and therefore misleading. The information is extracted from some preliminary estimates made by ISO staff in the early stages of the McKinsey study. The ISO Background Report, purported to be the source, presents the information differently than shown in this table, stating that manual rated premium might be up to 10%; small (a) rated up to 30%, package policies possibly as high as 30% and the composite group at least 30%. Since that time the staff of the Commerce Department has been provided with better estimates of the distribution of product business based on information from the ISO closed claim study, but they apparently chose not to use it. (page V-56)

Table V-4: Interagency Task Force staff were advised by ISO that there are substantial errors in this table. Although ISO is cited as the source, it did not prepare this table. Presumably it was derived from ISO-supplied data, but it contains over 50 factual errors. (pages V-57 - 58)

Table V-6: Contains over 60 factual errors, most of which are in the third column. (pages V-60 - 60a)

Table V-22:, There is an error in the bodily injury column and the distribution of claims in the property damage column is incorrect. (Table V-20, page V-74)

Table V-23: This table contains several rounding errors.(Table V-21, page V-75)

Table V-33: The total for 1975 is incorrect; therefore the percentage change figure is incorrect. We cannot reproduce any of the other totals. (Table V-31, page V-83)

In conclusion, it should be noted that there are other sections of the report which draw upon ISO ratemaking data and closed claim analysis. Some of the errors in those sections result from apparent confusion between insurer Annual Statement reporting requirements and statistical plan procedures used in capturing data for ratemaking purposes. Other errors result from misreading the closed claim study. A thorough review of those sections was precluded by the time contraints.

Maria A. Watters
Vice President

The ISO commentary on Chapter V was entered in the record of hearings conducted by the Subcommittee on Capital, Investment and Business Opportunities of the House Committee on Small Business (John H. LaFalce, D.-N.Y., Chairman) on November 28, 1977, and also forwarded to major insurance trade associations. In light of the questions raised by the detailed nature of the commentary, it was deemed appropriate to include the product liability staff's analysis of its content.*/

---

*/ The corresponding page numbers in the Final Report are indicated parenthetically after the analysis of each of ISO's comments.

NOTES ON ISO COMMENTS ON CHAPTER V OF TASK FORCE REPORT

This paper provides commentary on each of the specific comments made by ISO on Chapter V of the Final Report of the Product Liability Task Force.

Page V-4, lines 211-2. ISO notes coverage is dependent upon liability or negligence and is not provided for all product-related damages. The report states that on an "occurrence" basis, "coverage is provided for all product-related damages that occur during the policy period." The report statement could have been more artfully worded. The emphasis was intended to be on the fact that under an "occurrence" policy the insurer agrees to defend all claims based on product-related damages where such damages were allegedly sustained during the policy period and to pay damages on such claims when the insured is found or deemed to be liable. The ISO statement is imprecise in that coverage includes defending certain claims whether or not liability or negligence is ultimately found.(V-5)

Page V-8, lines 443-446. ISO comments that rating methods other than manual rating use statistically derived rates, i.e. composite rating (when based on manual rates) and loss rating. The report states that manual rating "is the only rating method which uses published rates which have been statistically derived from reported claims experience." [underscoring added] Manual rating is the only rating method that exclusively uses statistically derived published rates. Furthermore, while manual

rates have been used in composite rating in the past, as ISO has noted, composite rating is no longer used for product liability coverage. Loss rating does not rely on published statistically derived rates, but rather, relies upon the past experience of the individual insured. The report statement is therefore believed to be accurate. (V-10, last paragraph)

Page V-9, lines 450, 473 and 486. See comments under ISO comments on Table V-3. (V-10 - 11)

Page V-10, line 497. The report statement does not appear to be incoherent as alleged by ISO. The distinction seems to be that the report states "ISO requested that composite rating for product liability not be used after January 1, 1977" whereas ISO states that it "has filed an amendment to the Composite Rating Plan to eliminate product liability coverage from composite rating after January 1, 1977." The distinction is subtle. (V-12)

Page V-10, lines 545-7. The report states, "the rate increases, established by ISO in August, 1976, and December, 1976, provide an indication of the magnitude of product liability premium increases which have occurred and are likely to occur in the near future." The Task Force stands behind this statement. The December increases referred to are the (a) rate increases referred to by ISO as appearing in the ISO Circular Letter or January 21, 1977. The following areas of disagreement exist:

1. ISO claims the December-January (a) rate 'suggestions' should not be defined as 'rate increases'. We disagree. In fact, the (a) rates did show increases. The distinction seems to lie in the fact that ISO does not call the (a) rates, 'rates.' ISO seems inconsistent on this point since they note in the last two lines of Page 3 of their comments that "the full effect of the August, 1976, increases and the January, 1977, suggested (a) rates should be realized [by now].

2. ISO disagrees with our conclusion that the rate increases provide an indication of premium increases which have occurred and are likely to occur in the near future." It would appear that ISO misread the sentence since they seem to believe the sentence refers to 'rate' increases likely to occur in the near future. In fact, the statement refers to the fact that the new rates already established have caused premium increases and that these premium increases are being felt in policy renewals that have occurred and that are occurring. (V-13)

Page V-11, lines 550-3. ISO claims that the report's discussion of ISO ratemaking procedure leaves the reader with the impression that ratemaking is strictly subjective and judgmental, rather than based on standard credibility theory. The lines complained of read as follows:

> "Having determined the amount of an overall average increase in rates, ISO assigns weights to individual product classes. These weights, based on the limited experience data reported to ISO (see Table V-3) and subjective judgments, are used to factor the individual rates...."

While the Task Force recognizes the utility of 'standard credibility theory' as used in the insurance industry, it also recognizes that credibility theory requires a base of claims experience date upon which to predicate its use. In addition to its concern about the availability of a data base, the Task Force has noted that some writers question the reliability of the standard credibility theory even when sufficient data is generated to provide credibility of unity. The report acknowleges the use of data, where available, but also notes that ISO's actual historical claims data is quite limited. Necessarily, ISO must rely upon subjectivity in those areas where they lack data. (V-13, first paragraph)

Page V-11, lines 556-7. ISO again argues that there were no rate increases in December, 1976. As noted previously, this reference is to the (a) rate increases which ISO chooses not to define as rate increases. Since the (a) rates are sent to insurance companies for use in establishing rates and since they were increased in December or January, 1976-7, the Task Force considers then to effectively be rate increases. (V-13)

Page V-11, lines 572-5. ISO claims this is an incorrect statement suggesting further rate increases in the future. The Task Force stands behind the statements in the report as written. The first part of the statement notes that "...for most of the monoline rated products classes, insurance costs have increased or will increase and that some of these increases will be substantial". This statement relates directly to the effect of the rate increases ISO has published or otherwise established in the monoline rates, and refers to these existing rate increases being reflected in premium increases upon renewal of policies. The second part of the statement notes that "As noted on p. V-23, continued reliance on the current methodology for determining the need for rate increases could result in further rate increases in the near future". [underscoring added]. This statement does not say that there will be rate increases, but, using ISO's figures and the methodology laid forth in the ISO Background paper, the Task Force calculated that such are likely to be forthcoming if the usual methodology is used. (See Report, p. V-23). (V-13 - 14)

Page V-12, lines 596-604. ISO claims the description of the new Commercial Statistical Plan is garbled and the dates are wrong. The explanation of the substance of the Plan seems consistent with the ISO Background Report; however, the date given in the report may be erroneous. The ISO Background Report, dated December, 1976, refers, on Page 6, to "the new ISO Commercial Statistical Plan (CSP) currently being prepared for implementation..."

It is our belief that the implementation date was to be June, 1977, but we cannot validate this from any written documentation readily available. In any event it was in preparation at the end of 1976, the discussion therefore remains valid. (V-14)

Page V-12, lines 611-20. ISO claims that this section accurately describes current ISO procedures but gives the opposite impression. The section states that "to be statistically sound, rates for each product class should be based on the claims experience per unit of exposure." Historically, ISO has not collected sufficient data to be able to develop statistically reliable rates based on claims experience for other than the manual rates. Small (a) rates have not been statis tically sound and are acknowledged to be useful only as 'guides'. Hopefully, ISO's new statistical plan will permit the collection of sufficent data, but adjustments in classes may still be necessary and considerable time may be necessary to accumulate sufficient data for some product classes. (V-14 - 15)

Page V-12, lines 623-5. ISO claims their procedures are described inaccurately. The sentence complained of reads:

> "the procedure....is based on aggregated incurred losses for each policy year. In essence, the procedure amounts to determining whether premiums have been adequate to pay for incurred losses and making adjustments in rates accordingly."

ISO's comment regarding past adequacy is well taken. The report statement might better have read "whether existing premium rates will be adequate to pay for future estimated losses". It is, however, essentially consistent with the ISO Background Report (Attachment 4, Sheet 5) which says:

> "The loss trend factor is then applied to the incurred losses and loss adjustment expenses reflecting loss development. The result is divided by the earned premiums at current rate levels adjusted by the exposure offset factor. The quotient is called the loss ratio, and it represents an estimate of the percentage of premiums at present manual rates that will be required to pay claims....during the effective period. [Underscoring added].....In order to determine the indicated rate level increase, the loss ratio....is divided by the expected loss ratio".

The result of this calculation is the percent change necessary. In essence the methodology compares current rates with current loss expectations adjusted to approximate future possible costs. (V-15, second paragraph)

Page V-12, lines 627-9. ISO disagrees with the Report statement that ISO procedures result in rates for most product classes which are not statistically sound, or reflective of actual claims experience. We stand by the statement in the report. The (a) rates are not currently statistically reliable, and ISO has not historically collected claims data on all claims (See Table V-3). (V-15, third paragraph)

Page V-12 and V-13, lines 631-73. ISO presents several comments in this paragraph:

1. ISO agrees that a classification plan containing fewer classes would result in more statistically significant rates, but argues that the peculiar characteristics of the individual classes would be lost. This would be true if sufficient experience data were availble for each discrete product class. The reason that the Task Force suggested the merger of certain classes with similar product risk characteristics was that for some existing classes there is insufficient experience data available to allow the peculiar characteristics of the individual classes to be adequate reflected in the rate assessments.
2. ISO argues that more heterogeneous class definition could result in market dislocations. While such class mergers might result in broader risk spreading, it is unlikely that it would result in greater market dislocations than are currently being experienced by firms whose premiums are extremely high and bear no apparent relationship to either the experience of the firm, other firms in the product class, or the product class as a whole.
3. ISO further claims that existing ratemaking procedures result in statistically reliable rates because of the use of credibility theory and hazard weights. As noted previously, credibility theory and the development of

hazard weights are appropriate only where there is a sufficient data base upon which to predicate the use of credibility theory and the development of weights.

4. The Task Force recognizes that full credibility by class is not necessary and that ISO rate classes are not the same as the product codes used in the closed claim survey. The closed claim examples were used only to illustrate the point the claim experience is generated slowly for some products.

The overall point made by the Task Force report in this section was that some better means should be found to permit the establishment of rates that are related to product risk. This process may involve the collection of far more data, the merger of product classes or a combination of the two. The Task Force attempted to identify means by which rate could be more related to risk but is not attempting to dictate the precise means by which it should be done. (V-15 - 16)

Page V-14, lines 684-9. ISO agrees that a reliable data base is needed but alleges that the report fails to note ISO's improved data collection procedures. We believe the Report does note the improvements in the ISO data collection. (V-16 - 17)

Page V-14, line 706. The report states that data related to claims trends are not available. ISO argues that they are available and have been reported to the Task Force. To the

best of our knowledge the only data given the Task Force is that which shows trends in incurred losses for monoline policies only. Such data represents only a relatively small percentage of the total product liability claims experience and, more importantly, it is not the equivalent of actual historical claims experience since the incurred losses include both paid claims and estimates for potential liabilities. The only published actual claim experience is that collected in ISO's Closed Claim Survey. While those data are valuable, they represent only a one time collection of data and alone they cannot be used to show trends over time. If such surveys of actual claims experience were to be continued on an annual basis, trends in actual claims experience would be generated. While the data collection need not be as voluminous as was collected in the ISO Survey, certain of the data items should be continued to be obtained to ascertain actual trends in claims over time. This may also require more precise definitions of covered exposures. (V-17)

Page V-14, lines 711-14. ISO argues that data on trends in severity of product liability claims are available. The Report says they are not. One indication of the fact that neither trends in frequency or severity of claims are available is the

fact that until recently, no one, including ISO or the Task Force, could effectively either support or refute the allegations of the 'million claims filed in 1976'. Given the facts that the total numbers of claims filed is not known, and total exposure is not known, it is impossible that severity trends could be known. The fact that there have been increases in aggregate projected losses or even in actual paid claims are not in themselves indicative of increases in severity without appropriate correlations to exposure units. (V-17)

Page V-16, lines 781-6. ISO suggests that the MAPI survey merely reflects the effect of the increases on renewals. We agree. The point is that the premiums for the respondents did show increases. (V-19, third paragraph)

Page V-23, lines 1114-20. ISO claims there will be a leveling off of rate increases, and claims the report is misleading in suggesting further rate increases may be expected. The report made reference to calculations made by the Task Force staff using ISO's figures and ISO's methodology and concluded that if these were the basis for determining the need for future rate increases, then "further manual rate increases may be anticipated." This is not to say that there will be further increases but only that reliance on current ISO figures and methodology would seem to present the case for such increases. (V-28, last paragraph)

Page V-24, lines 1154-62. ISO claims every field of data containing economic information was trended and the report is claimed to be slightly misleading in this regard. The report states, "ISO chose to apply a trend factor to certain of the payments reported," and also states that all cost data on each claim was trended. The report's allusion to 'certain payments' was intended simply to reflect that costs were adjusted assuming a July 1976 occurrence. Presumably any claim in the survey occurring in July 1976 would not have been trended. The report

intended no allegation of arbitrary selection of payments to be trended. (V-29, last paragraph)

Page V-24, lines 1167-9. ISO and the Task Force staff have a basic disagreement over the appropriateness of trending the Closed Claim Survey. We also disagree with ISO's assertion that economic values are a function of the time of occurrence. More importantly, the use of trended data to discuss distributions within the sample, as has been done by ISO, is misleading and distorts information about characteristics of claims closed during the survey period. (V-30)

Page V-25, lines 1186-9. We agree that the untrended data do not describe claims occurring recently. They describe only those claims closed in the survey period by the reporting companies. We disagree with ISO's claims that the trended data necessarily accurately describe future claims. (V-30)

Page V-25, lines 1192-8. ISO claims that they supplied the Task Force with information about the fraction of the total product liability premium written by the participating carriers. This is true but what is not known are the fractions of the total premium written when the closed claims were initiated nor the fraction of the total losses incurred during the period. ISO was not able to provide more than the fraction of the premium currently written by these companies. (V-30 - 31)

Page V-25, lines 1203-12. ISO claims that the deficiencies of the Preliminary Report on the Closed Claim Survey do not exist in the Final Report of the survey. Unfortunately, the Final Survey Report was not available to the Task Force until after the preparation of the Task Force Final Report. In the opinion of the Task Force Staff, the deficiencies of trending and representativeness still exist in the final ISO report. (V-31)

Page V-27, lines 1256-71. ISO notes that they ran their data both with and without the Liberty Mutual submissions and that the results were not affected. ISO therefore challenges the reasonableness of the "assumption made" in the Task Force Report. The assumption in the Report referred to the claims listed in Table V-24 in the $1,000-$5,000 payment range. There is a typographical error in the Task Force Report text. The range should have read $1-$5,000 which is the range given in the table. The table shows that Liberty had 5,498 paid claims within this range in 1976. The average amount of the paid claims is $473. The point being made in the report was that the majority of the claims paid by Liberty Mutual were for less than $1,000 and that the inclusion of those claims might have significantly affected the results. ISO's data runs were conducted with and without the Liberty Mutual claims submitted, i.e., all claims for the first month but only those in excess of $1,000 after that time. It was the suggestion of the Task Force Report that the inclusion of the very numerous

claims for which payments under $1,000 were made as well as those for which no payment were made might have affected the results. This assumption has not been tested by ISO. (V-32 - 33)

Pages V-27 and V-28, lines 1283-1293. This is a summary of ISO's comments regarding trending; namely,

1. The preliminary report deficiencies does not exist in the final survey report.
   Comment: While the Task Force did not comment on the Final ISO Report since it was not available certain of the deficiencies appear to remain.

2. The survey presents a representative sample.
   Comment: The survey is not necessarily representative of more than the reported experience of the participating companies. See note above regarding Liberty Mutual data.

3. A continuing closed claim survey would not provide any additional information beyond that already provided.
   Comment: We disagree. A continuing closed claim survey would provide actual trend data showing changes in actual claims over time.

4. Untrended data cannot provide valid information about the current claims environment.
   Comment: This is true but neither can trended data. Only by collecting the untrended data over time would permit better estimates of the future environment by tracking actual changes over time. (V-33)

Page V-38, lines 1798-1804. ISO claims that there is no cumulative effect of IBNR reserves for primary companies and reinsurers because rates are determined on a direct basis. The report refers to the danger of a possible redundancy in considering reserves. This still appears to be the case whether one directly considers IBNR or utilizes loss development factors, which appear to be surrogates for IBNR. (V-46, first paragraph)

Page V-38. ISO again alleges that the report fails to recognize the major steps which have been taken to alleviate the data unavailability problem. In other places the report notes changes ISO has made. Nevertheless, this does not affect the fact that sufficient data are currently not available and that they are needed in view of the impact of premiums on business. (V-47)

Page V-40, lines 1909-14. ISO claims that their practices are in accordance with the report suggestions. We hope so but have no way of verifying the assertion. (V-49)

Page V-41, lines 1929-32. ISO claims that state regulators get countrywide experience data from ISO. The report simply made the point that regulators require access to data on all product liability experience to adequately evaluate rate requests. The main point is that more data is needed. It could also be pointed out that state legislative directives mandating the collection and compilation of state data on product liability claims will not suffice in most instances to provide an adequate data base for the regulators in the state. (V-49)

Table V-3. ISO claims the distribution of product liability premium is misleading and states currently that the report figures were extracted from preliminary estimates made by the ISO staff. There is not a significant difference, however, between the Table figures and the figures ISO uses in its letter. The figures are reproduced below:

	Task Force Report	ISO Letter
Manual rated	10 - 15%	≤ 10%
Small (a) rated	30 - 35	≤ 10
Package	30	≤ 30
Composite, loss rated and large (a) rated	20 - 30	≥ 30

It should be noted that ISO does not take issue with the table summary of the claims experience which is reported to ISO. This summary documents the very limited claims data which have been reported to ISO in the past and which form the basis for the rates which are developed by ISO. (page V-56)

Table V-4. ISO claims that this table contains over 50 factual errors. They have not identified the specific errors, therefore the allegations cannot be responded to directly. The table was prepared by the Task Force staff using ISO data. (pages V-57 - 58)

Table V-6. ISO claims that this table contains over 60 factual errors, most of which are in the third column. Again, ISO has not identified the errors with specificity. (pages V-60 - 60a)

Table V-22. ISO claims that there is an error in the bodily injury column that the distribution of claims in the property damage column is incorrect. The Task Force staff calculated these figures from the ISO closed claim tables and believes them to be accurate. Rounding may provide minor distortions. (Table V-20, page V-74)

Table V-23. ISO notes several rounding errors. While they do not identify them, this matter is of minor significance. We use different rounding procedures than they do. (Table V-21, page V-75)

Table V-33. Most of this table is identical to that produced in the Insurance Study. Some corrections should be noted however. They are reproduced below. (Table V-31, page V-83)

TABLE V-33. SURPLUS LINE PREMIUMS REPORTED BY MAJOR STATE INSURANCE DEPARTMENTS

	(Premiums $ million)			
Top 10 States (1975)	1972	1973	1974	1975
California	38.4	41.1	54.0	78.1
New York	50.6	44.3	43.6	72.2
Texas	30.9	35.9	48.5	66.9
Louisiana	44.1	43.2	44.9	60.1
Florida	15.3	18.4	20.8	34.5
Pennsylvania	12.2	10.4	16.4	29.4
Illinois	21.3	25.9	22.8	27.9
New Jersey	18.1	19.7	18.1	24.8
Michigan	N.A.	N.A.	N.A.	N.A.
Georgia	5.9	6.9	8.8	15.5
All other states	79.3	97.7	114.7	190.8
Total	316.1	343.5	392.6	612.8
Percent increase Year to Year		72-73 7.8%	73-74 16.3%	74-75 51.0%

Source: State Insurance Department Annual Reports.

INSURANCE FROM CNA

CNA Plaza
Chicago, Illinois 60685

Edward J. Noha
Chairman of the Boards and
Chief Executive Officer of
the CNA Insurance Companies

November 15, 1977

The Honorable Sidney L. Harman
Under Secretary of Commerce
Department of Commerce
Commerce Building
14th and Constitution Avenue, N.W.
Washington, D. C. 20230

Dear Mr. Under Secretary:

In response to your request for my views as a member of your Advisory Committee on Product Liability, I am pleased to attach a series of general observations and specific comments on the Interagency Task Force on Product Liability.

You will note I conclude that the Report, although generally balanced, is long on analysis and short on recommendations--particularly in the need for immediate tort reform and modification of the contingency fee system. While I recognize that a policy decision was made to avoid specific recommendations for action on the part of Congress or the state legislatures, I must state my genuine disagreement with that decision. In my view, the time for effective tort reform is long overdue and thus I had hoped that the Report would specifically address and seek to resolve the problem rather than confining itself to a more abstract discussion of the issues.

However, the Report does lay a foundation for future action by delineating the underlying causes of the problem and focusing on areas of needed reform. To that end it is a contribution to the collective understanding of the subject and I thank you for the privilege of serving as a member of your Task Force.

Sincerely,

E. J. Ruha

cc: Judge Ned Price
Chairman, Advisory Committee
Edward T. Barrett
Secretary, Interagency Task Force

MEMORANDUM

TO

INTERAGENCY TASK FORCE

ON

PRODUCT LIABILITY

Edward J. Noha
Chairman of the Boards
CNA Insurance Companies

Member, Advisory Committee
on Product Liability

November 15, 1977

A. General Observations

1. While the extension of time for reply was helpful, the overall period for review by members of the Advisory Committee was still unnecessarily short. The necessity of reviewing the entire Report for factual errors within the first week produced considerable inconvenience to all concerned. Since that time, we have examined the Report in considerable detail. In the process however, the Task Force may have lost a valuable commodity--the opportunity for a fully developed interchange of views between members of the Advisory Committee and representatives of the Task Force. This is not to say that the comments of the Committee will not be considered fully; only that a little more time for reflection and internal discussion would undoubtedly produce a better result.

2. The Report is generally objective and factual. A great deal of thought and effort obviously went into drafting the various components of the final product. However, the tenor of the Report is occasionally marred by unfortunate and unnecessary references to matters such as a possible link between stock market losses and increases of premiums or the veiled suggestion that

insurers have been less than candid with the public or are somehow manipulating reserves to understate investment income and hide profits. To some extent these inferences are the result of what appears to be a reluctance to fully utilize the findings of the contractor for the insurance study; in other cases, particularly in Chapter V, these innuendoes reflect a less than complete understanding of the insurance industry and the principles of integrity and trust on which it was built and run. In either case, the generally objective tone of the Report is impaired. The end result may well be a feeling of uneasiness or concern in some segments of the insurance industry and state regulators as to the underlying intent or bias of the Task Force.

3. The Report is long on analysis and short on recommendations. While this is undoubtedly due to inherent practical and political limitations in the drafting of the Report, there should have been more concrete recommendations in certain areas such as tort reform and further clarification of the federal reinsurance proposal. Since the Report will undoubtedly be the source document for serious discussion of the

problem for years to come, it could have enhanced the possibility for progressive change by taking a harder stand on several key issues such as the contingent fee system or the role of the Federal Government in opting for real change. The absence of a series of decisive recommendations ultimately reduces the long term effectiveness of the Report as a vehicle for the stimulation of further action.

4. On balance the work is of generally high quality and reflects a great deal of effort expended in an attempt to define the scope and nature of a pervasive problem. As such it has laid a necessary foundation for future action. However the stimulus or catalyst for action has yet to be applied.

B. Specific Comments

Chapter I - The Causes of the Product Liability Problem

1. The list of causes--the liability rate-making system, tort-litigation system and manufacturing process is sound but much of the remaining discussion leaves unstated the effect of social and economic pressures, particularly those associated with the shift from a system of fixing responsibility to one of finding a means to compensate all injuries regardless of fault, i.e., the new sense of entitlement.

2. The nine target industries selected by the Task Force are well recognized as having particular liability problems. Thus the findings may not necessarily represent the entire manufacturing industry and the Report's credibility is affected.

Chapter II - The Legal Study

1. The legal study appears to have been unduly preoccupied with a mechanical review of the factual elements of product liability cases and with what the courts say about the law of product liability, as opposed to how they actually apply it in daily situations. Courts are notoriously self-conscious about observing the proprieties of the law in written opinions and less so in settlement negotiations or rulings in open trial. For example, more study should have been given to the manner in which courts apply rulings governing the availability of traditional defenses or rebuttable presumptions of liability. In short, the legal study lacks the feel of the nuances of the courtroom and an experienced view of how the law is administered in action.

2. Certainly more study should have been given to the factors underlying the increase in awards in action cases. It would have been useful to know what effect the claim for punitive damages may have on the size of awards or how juries are reacting to the growing product liability cases in the plaintiff's bar with the rise in the number and growing complexity of such litigation. To what extent has the crisis been the product of the bar's interest in new areas of remunerative litigation?

Chapter III - The Impact of Product Liability on Selected Industries

1. Although some questions can be raised about the accuracy and effectiveness of a telephone survey, it probably was the only feasible approach given the time and expense factors involved in conducting the study.

2. The Report correctly surmises that unavailability of insurance coverage is not widespread but that the cost of insurance has increased substantially since 1974. The Report also finds that there has been a signficant increase in the number of claims and the amount of damages sought. However, the Report states that the industry contractor found no apparent increase in the frequency of product-related injuries. The data base for this conclusion is very questionable in that it is based on closed workers' compensation cases in the State of New York only for the period 1966 through 1972. More current data could certainly have been used. The Report later recognizes these shortcomings.

Chapter IV - Product Liability Prevention Techniques

1. An increase in the availability and quality of loss prevention services is a welcome trend. Perhaps more effort or study should be given to how this service can be improved and what if anything can be done to encourage even broader cooperation between insurers, manufacturers and government agencies concerned with quality control.

2. The discussion of loss prevention techniques was superficial despite the fact that it was considered one of the three major causes of the product liability problem. Although the Report is over 500 pages long, only 14 pages were specifically devoted to the issue of product liability prevention techniques.

Chapter V - Product Liability Insurance

1. Since the ISO Closed Claim Study has now been completed and published, its use might improve the quality of the Report and also eliminate the lack of credibility objection due to the small sample of claims reviewed in the ISO preliminary report.

2. While the recommendation that product liability premiums be reported as a separate line in the Annual Statement has merit, the recommendation that insurers also report investment income earned on the unearned premium and loss reserves for products liability implies that investment income is not now considered in the setting of products liability rates. Insurers do in fact take investment income into account in setting rates. The small loading for profit and contingencies (5%) reflects that fact. If expected investment income must be taken into account in rate filings with regulators, the profit and contingency factor will have to be increased so that insurers can get a return on capital and surplus commensurate with the risk involved in writing product liability.

3. In the opening paragraphs of Chapter V the Report states that if premiums are commensurate with the risk but are still too costly, then the cause of the problem is outside the insurance system. But if the data reveals that

premiums are unreasonably assessed, the insurance mechanism needs revision. Chapter V makes clear that there is insufficient data to make a judgment but then goes on to implicitly assume that if all products liability premiums and losses could be separately reported and properly classified, then rates can be established with a very high degree of actuarial certainty and the performance of the insurance mechanism properly evaluated. This assumption does not allow for the high degree of judgment necessary in setting rates for individual risks, particularly in a time of monetary inflation, expanding liabilities and a "deep pocket" public attitude. Even if the industry had product liability data for 1971 through 1977 which was complete and accurate, it could not establish rates for 1978 with complete confidence that they accurately reflected the exposure. Thus, the Report should recognize that past data, however complete, accurate and credible, has a limited value in establishing future rates for a large number of products.

4. The comparison of the product premiums charged to small and large businesses, concludes that small firms have experienced significantly greater increases than large firms. That conclusion is not supported by sufficient data. Large firms can mitigate the impact of a premium increase by purchasing a higher deductible or electing a retrospective

rating plan as the Report itself recognizes. Hence there is no common denominator for small and large businesses upon which a meaningful comparison can be made and therefore the implication in Chapter V that the insurance industry is unfairly discriminating against small business is totally unwarranted.

5. The conclusion that the insurance regulator could regulate product liability rates more effectively if he targeted for special attention those rate increases which exceed a threshold amount is an interesting concept. However, it may not prove practical in application because a large number of classes are (a) rated and because underwriters often find it necessary to vary even manual rates for individual risks based upon judgmental factors.

6. Although the discussion of underwriting experience data states that insurers may be underreserved, the overall impression left by the commentary is that carriers are overreserved and thus, by implication, that rates are excessive. If the Report placed more emphasis on the fact that in recent years, the reserves of insurers have proven seriously deficient because of inflation, legal doctrines imposing greater liabilities and a "deep pocket" social attitude and that these causes are still present--the tone of Chapter V would be more balanced.

Chapter VI - Major Impacts of Product Liability

1. In attempting to synthesize what the legal, insurance and industry data and other information show, this chapter incorporates whatever shortcomings may be contained in previous chapters.

2. Conclusions regarding compensation obtained by persons injured by products are based on the ISO preliminary closed claim survey. More credible and up-to-date data is contained in the final ISO Report.

Chapter VII - Remedial Approaches in the Field of Product Liability

1. This chapter discusses various proposed tort reforms. Unfortunately, the authors seem to have two philosophical beliefs which color their analysis. First, is that almost any injured person is entitled to some form of payment. Second, is that these payments should be divided among all negligent parties according to their respective fault. The authors are extremely hesitant about supporting any proposal which they feel might reduce the amounts received by injured persons. The only recommendation advanced with any vigor is that a manufacturer who has paid a product liability loss to an injured employee should be allowed to seek contribution from the employer whose negligence contributed to the injury. While this proposal has a certain emotional appeal, such contribution would have to be paid under the employer's liability coverage provided in the standard workers' compensation policy--a line of business which is already extremely unprofitable.

2. The Report contains two statements attributed to Mr. Howard Clark of the Federal Insurance Agency which are in error. The first is that a comprehensive general liability (CGL) policy provides coverage for payments due under a hold harmless agreement. A CGL specifically

excludes liability assumed under a contract from coverage and such coverage must be specifically endorsed therein. The other error is that, if a manufacturer is allowed to seek contribution from an employer whose negligence contributed to an employee's injury, the employer would have no insurance coverage for this contribution. The fact is that these amounts would be payable under the employer's liability coverage of the standard workers' compensation policy.

3. The reluctance of the authors to make any concrete recommendations is particularly evident in their discussion of proposals to abolish attorney's contingency fees, the collateral source rule, awards for pain and suffering and place limitations on the use of punitive damage awards. The Report halfheartedly suggests that attorney's contingency fees be regulated according to a sliding scale similar to that presently used in New Jersey, that awards for pain and suffering be based on a fixed schedule, that amounts already paid to an injured person by the government, e.g., Medicaid, be deducted from any judgment against a product manufacturer and that, in awarding punitive damages, the judge take into account previous punitive damages awards involving the same product. These suggestions while helpful simply do not go far enough. More fundamental changes are needed if the problem is to be solved.

4. The tendency of the authors to opt for the easy solution rather than making hard decisions is particularly evident in their discussion of modifications to the insurance mechanism. The authors state that for there to be any reduction in product liability insurance rates, these rates would have to be subsidized in the absence of significant tort reform. Unfortunately, while the Report admitted that the proper source of the subsidy in such a case should be the federal government, it goes on to confuse the issue by stating that the private insurance industry would be an acceptable alternate source.

5. The Report discusses and rejects the various no-fault proposals which have been advanced with the conclusion that they may be too easily manipulated by manufacturers to the public's detriment. However, the Report then states that the concept of no-fault is worthy of further study to determine if a no-fault system could be developed that would be relatively easy and inexpensive to administer while placing appropriate incentives on manufacturers to improve the safety of their products. The end result is confusion and a complete lack of direction on this issue.

6. Finally, although the Report concludes that certainties in the tort litigation system are one of the three main causes of the product liability problem (along with "inadequate" rate-making procedures and unsafe products) it stops short of emphasizing the absolute need for meaningful tort reform. Rather it merely "suggests" consideration be given to several specific modifications in the statute of limitations, available defenses, use of comparative negligence, allocation of responsibility between judges and juries and penalties on lawyers bringing frivolous suits.

While their "suggestions" are useful and appropriate, the fact is that they will not become reality without a strong endorsement for action on the part of the state and perhaps federal legislatures. As noted in my General Comments supra, this is the single most important shortcoming of the Report. Hopefully the momentum for action generated by the preparation of the Report can be rekindled by the Congress and state legislatures. But in the interim, we will have

lost a valuable opportunity for effective change at an early date. Unfortunately, such opportunities do not often reoccur in our political process at frequent intervals.

Respectfully submitted,

Edward J. Noha
Chairman of the Boards
CNA Insurance Companies

Member, Advisory Committee
on Product Liability

November 15, 1977

NED PRICE
Member

HUGH C. YANTIS, JR.
Chairman

DURWOOD MANFORD
Member

MRS. PAT WAGNER
Chief Clerk

E. J. VOORHIS
Commissioner of Insurance



STATE BOARD OF INSURANCE

1110 SAN JACINTO

AUSTIN, TEXAS 78786

November 15, 1977

The Honorable Sidney Harmen
Under Secretary of Commerce
U.S. Department of Commerce
14th Street
Between Constitution Avenue and E. Street, N.W.
Washington, D.C. 20230

Secretary Harmen:

The Department of Commerce is to be commended in it's role as chair of the Interagency Task Force on Products Liability. The volumes of material to be reviewed and the complexity of the process for this review were a challenge that could be overcome only by dedicated, knowledgeable staff such as yours. They are to be individually commended.

As you know, I have been concerned about the time necessary to review a document that cross-references so many outside sources of information. As I emphasized earlier in conversations with your staff, we found that it could take a week simply to identify "where in the report" one's interests are mentioned. As such, I have attempted to review only those sections directly impacting on the insurance sector. My specific remarks are focused under two general headings: (1) a historical perspective in analysis of recommended changes in government regulation of products liability and (2) the role of voluntary non-legislative solutions to products liability problems.

My comments due to the time factor and your request for confidentiality have not been reviewed by anyone from the National Association of Insurance Commissioners, or the Texas Department. I am certain however that your report will be a focal point for both in future deliberations regarding products liability.

It has been an honor and a pleasure to work with the Department over the past year.

Sincerely,

Ned Price, Chair
Department of Commerce Advisory Committee
on Products Liability

Comments

by

Judge Ned Price

on the

Final Report

of the

Interagency Task Force on Products Liability

This analysis focuses on the following Chapters of the final report:

Chapter I	Introduction and Causes
Chapter V	Product Liability Insurance
Chapter VI	Major Impacts of Products Liability
Chapter VII	Remedica Approaches in the Field of Product Liability

This focus allows overall review of the major conclusions relative to the insurance industry and the current system of government regulation of the industry in providing product liability insurance coverage. This review does not attempt a line-by-line analysis, but rather addresses the broad issues of public policy discussed in the enumerated sections of the report under two broad topics:

I. A Historical Perspective in the Analysis of Recommended Changes in Government Regulation of Products Liability Insurance

II. The Role of Voluntary Non-Legislative Solutions to Product Liability Problems

Introduction:

At the outset of the cry "product liability crisis" government regulators through the National Association of Insurance Commissioners (hereafter referred to as the NAIC) recognized the probable contribu-

tion of the insurance sector to any problem occuring in the area of products liability. (The two other potential contributors, the legal system and industry practices will not be reviewed in this discussion.) However, in the Interagency Task Force's Final Report on Products Liability (hereafter referred to as the ITFR) while some direction is given to state insurance regulators for reviewing the product liability insurance rate making system and other insurance companies practices, little recognition is given to the complex of state regulation that exists when analyzing remedies in the final chapter of the report. This oversight is critical to legislative enactment and subsequent implementation of many if not all of the enumerated insurance remedies.

The other general failing of the report is the limitation of remedial proposals to major legislative solutions. Although the report mentions many areas for improvement in the current rate making system, at no time are these discussed in the summary sections of the report. One is left to "preening" them from between the pages of the report.

It is also curious that the report begins by stating that:

> "In the early period some extraordinary assertions were made that we (the Federal Interagency Task Force) were unable to validate. For example, it was alleged that one million product liability claims would be filed in 1976. The insurance industry's own best estimate is today 70,000. Many letters told about cases where it seems transparently unfair for the plaintiff to recover damages. We (FITF) have found these so-called "horror stories" do not represent the standard of the day....."

then goes on to discuss the limited data available within the insurance sector (for a variety of reasons) but concludes with remedial insurance proposals that significantly impact the insurance industry and state regulation of that industry. Further an apparent

bias toward federal regulation is demonstrated when the remedies for the industrial sector include provision of technical assistance on loss prevention techniques, and statistical assistance on types of injuries but focus only on legislative solutions to the insurance sector that would pre-empt, not supplement or assist current state regulatory authority.

I. A Historical Prespective in Analysis of Recommended Changes in Government Regulation of Product Liability Insurance.

The broad underlying objective of the regulation of insurance by state government is the protection of the public from incompetent and fradulent operations of insurance companies.[1] This protection is necessary because "the parties to an insurance contract are not negotiators of equal weight in the market place."[2] This protection is afforded primarily through regulation of solvency. How then does a split in regulation of insurance between the federal and state government with some aspects of products liability either mandated by or regulated in Washington and other aspects of this line and general liability regulated at the state level affect this overall goal of protecting the policyholder? It is not considered.

Uniformity in regulation is idealized in considering federal residual market mechanisms but regulating one line of liability partially or wholly in Washington and the other liability lines in the states is hardly uniform. It could be viewed by some as simply a finesse to federal takeover of insurance regulation. Why not consider how the federal government can help the state system of regulation instead

of how the federal government can do it better than the states. The flaws in the current rating system can be overcome with a joint effort, but the flaws in implementation of a piecemeal system of federal and state insurance regulation may not be so easily averted. The FITF reports very aptly describes the products liability situation as not warranting "a direct federal product liability program at this time." However when the situation is reassessed to determine the need for such a program, the impact of such a program on the whole complex of state regulation should be given due consideration.

II. The Role of Voluntary Non-Legislative Solutions in the Products Liability Problem

Although scattered mention is made in the FITF report to individual, specific problems that can be addressed in the products rate making and regulation system, this body of solutions is nowhere summarized as a remedy to the product liability insurance problem. These adjustements to the system and the voluntary market assistance programs (MAP) that are functioning should be given an opportunity to work prior to discussion of additional insurance remedies such as captive companies, self insurance programs, mandatory loss prevention programs and unsatisfied judgement funds.

In addition to the lack of demonstrated need for such program, the current assessment of their potential is incomplete. For instance, what prevents the fradulent or incompetent management of a captive chartered through a trade association such that it merits special status by statute? Why are captives described "more efficient" in the heading summaries when

the subparagraph conclusions are that it is "uncertain as to the potential efficiencies of captives." Why do reduced insurance costs necessarily follow direct control over litigation and settlement? What is the logic underlying any proposed assessment against insurers for unsatisfied judgement funds? The questions in analysis of legislatively involved remedies could continue. But let me outline another area that must be more fully explored bofore legislative solutions are considered: rate making.

Texas has what are considered some unique rating laws on the books. And the Texas rating system for products liability has one characteristic not described in the final report. When "a" or judgement rates are developed in the categories approved under the ISO filing, they must be submitted to the department for review. And in instances where rates exceed a certain "threshold" figure (as suggested in the FITF report) additional justification for the rate increase is requested. Thus, rates in Texas are not "effectively uncontrolled" as described in the report.

The loophole in this system is, of course, the surplus lines market which is truly unregulated in regard to rates. But to attack the surplus lines market might, as the report further concludes restrict the current capacity to underwrite products liability more than it adds to rate making certainty. The effect of this additional step in the products liability rate making process should be more carefully reviewed and compared to other jurisdictions before legislative remedies are sought.

Conclusion:

As a regulator, I have participated in the development of voluntary, non-legislative remedial solutions to the problems in the products liability insurance system. Any assessment of additional remedies in the insurance system must be based on the success or failure of these voluntary solutions.

The National Association of Insurance Commissioners recognizes the need for more substantial data on products liability insurance. One attempt to separate products liability as a separate line on the annual statement failed in 1976, but will be attempted again. A questionnaire on products liability insurance that was submitted to the major industry trade associations i.e., file American Insurance Association, the Alliance of American Insurers and the National Association of Independent Insurers emphasized the limitations of current data on products liability. So the Task Force has revised the questionnaire to be administered on a state-by-state basis to individual companies. The Task Force is also soliciting specific underwriting case histories on several products categories to become more familiar with underwriting procedures. But most importantly the Task Force has taken to critical steps to alleviating availability problems where they are found to exist and to collect data of the scope of these problems in the States through market assistance programs. This information, we believe is an imperative precedent in analysing any attempt to mandate implementation of state programs for products liability by federal standards.

The time to study the products liability problem and implement

desired solutions can only be taken if temporary solutions are available. The NAIC has recommended with the cooperation of industry, voluntary market assistance programs or MAPS, in the states where the Commissioner determines a need exists. The purpose of these MAP committees is twofold. First they provide Market Assistance to Risks having difficulty placing their products liability insurance. And secondly they develop specific data on a state-by-state basis on the type and entent of products liability problems.

The states which are currently operating MAP Program include Connecticut, Illinois, Kansas, Maine Massachusetts, Michigan, Minnesota, New Hampshire, New Jersey, Ohio, Pennsylvania, Rhode Island, Virginia and Wisconsin. The states that are still in the preliminary stages include Arkansas, Indiana, Iowa, Kentucky, Louisiana, Nebraska, Tennessee, Texas and Washington.

It was recommended that the "MAP" Committee in each state be composed of licensed producers with knowledge and background in underwriting and pricing products liability, knowledgable representatives of insurers writing products liability insurance in the state and the Insurance Department. In Texas this Committee also has consumer, attorney, and business representatives. The duties of the Committee include:

1. Reviewing products liability insurance availability problems to be certain that all markets have been explored and assisting controlling producers in placing the business when necessary,
2. Negotiating extensions of coverage with required carriers where necessary to permit additional ex-

ploration of the market or accumulation of needed underwriting data,

3. Encouraging the development of alternatives volunatry markets including a referral program involving the use of voluntaring designated insurers participating in a voluntary quota share reinsurance agreements.

These committees report periodically to the Insurance Department regarding their activities, assessments of specific availability problems and recommendations. This program is not, of course, designed to guarantee coverage as in a pool and does maintain pricing flexibility subject to underwriting judgements.

A further step has been taken to tie the data available from these committees together. A centralized reporting form has been developed for all state MAP programs to report to the NAIC. This form will be finalized at the December meeting of the NAIC (draft attached) and will be used to summarize 1977 data and for periodic reports thereafter.

Summary:

While the Final Report of the Interagency Task Force on Products Liability is a commendable effort at synthesizing volumes of information about a complex problem, its analysis of remedies in the insurance sector:

1. places too great an emphasis on legislative remedies in the summary sections of the report,
2. buries non-legislative recommendations on adjustments to the current rate regulatory system in the body of the report,

3. is incomplete and somewhat biased in its analysis of state vs. federal regulation of insurance,
4. is incomplete in its charaterization of rate making procedures at least in regard to Texas, and
5. provides insufficient documentation of its conclusions concerning captive insurers, self insurance programs, unsatisifed judgement funds, and mandatory products insurance.

These limitations however do not diminish the importance of the document as a summary of current data on the products liability insurance mechansim.

[1] Mehr and Cammack, Principles of Insurance, 1966 (Richard D. Irwin, Inc.) p. 913

[2] Kimball, The Purpose of Insurance Regulation and Preliminary Inquiry in the Theory of Insurance Law, 45 Minn. L. Rev. 471, 523 (1961)

PRODUCTS LIABILITY
MARKET ASSISTANCE PROGRAM (MAP)
QUESTIONNAIRE

I. STATE: _____

II. ORGANIZATION OF MAP

A. Date MAP was established _____

B. Date of this questionnaire _____

C. Names of insurance department personnel who are members of or working with MAP:

_____

_____

D. Name, address and telephone number of MAP Chairman:

_____

_____

E. Names and affiliations of MAP members:

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

III. INSURANCE APPLICATION DATA

A. Total number of general requests for information about MAP to date: _____

B. Total number of formal applications for products liability insurance coverage received by MAP to date: _____

1. Number of applications returned to prospective insureds for incomplete information, etc.: _____

2. Number of applications currently pending before MAP or MAP subcommittee: _____

3. Number of applications which have received final action from MAP: _____

C. Number of prospective insureds submitting formal applications to MAP with gross annual sales of:

1. Under $500,000 _____

2. $500,000 - $1 Million _____

3. $1 Million - $2 Million _____

4. $2 Million - $5 Million _____

5. Over $5 Million _____

D. Types of products or completed operations for which at least one formal application for products liability insurance coverage was received. (Give 5 digit SIC code if possible.):

Type of Product/Completed Operation	SIC Code

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

E. List filing dates of all applications pending in III(B)(2) above:

_____

_____

_____

_____

_____

_____

IV. INSURANCE PLACEMENT DATA

A. For how many applications in III(B)(3) above was products liability insurance coverage placed through MAP? _____

B. Number of placements with:

1. Licensed Insurers _____

2. Unlicensed Insurers _____

C. Number of placements where applicant had gross annual sales of:

1. Under $500,000 _____

2. $500,000 - $1 Million _____

3. $1 Million - $2 Million _____

4. $2 Million - $5 Million _____

5. Over $5 Million _____

D. Type of products or completed operations for which placements were made through MAP (Give description and 5 digit SIC Code if possible):

Product/Completed Operation	SIC Code

E. Number of placements with deductibles of:

1. $5,000 or less _____
2. $5,000 - $10,000 _____
3. $10,000 - $25,000 _____
4. $25,000 - $50,000 _____
5. Over $50,000 _____

F. Number of placements under policies of:

1. Commercial Multiple Peril _____
2. General Liability _____
3. Other _____

G. Number of placements where the applicant's previous policy limits were:

1. Raised _____
2. Lowered _____
3. Remained the same _____

V. NONPLACEMENT DATA

A. For how many applications in III(B)(3) above was products liability insurance NOT placed through MAP? _____

1. Number of applications denied insurance coverage by MAP:

_____

2. Number of applications for which offer to insure was made but no insurance effected through MAP: _____

B. Number of nonplacements in V(A) above which involved an applicant with gross annual sales of:

1. Under $500,000 _____

2. $500,000 - $1 Million _____

3. $1 Million - $2 Million _____

4. $2 Million - $5 Million _____

5. Over $5 Million _____

C. Types of products or completed operations denied coverage in V(A)(1) above and reasons for denial (Give description and 5 digit SIC Code if possible):

Product/Completed Operation	SIC Code	Reason for Denial

D. Types of products or completed operations offered coverage in V(A)(2) above and reasons for not effecting insurance (Give description and 5 digit SIC Code if possible):

Product/Completed Operation	SIC Code	Reason Insurance Not Effected

VI. Please attach a copy of the plan of operation for the MAP, if any, and any other descriptive documents which illustrate the MAP's activities.

****

THANK YOU FOR YOUR COOPERATION

Fred G. Secrest
Executive Vice President

Ford Motor Company
The American Road
Dearborn, Michigan 48121

November 14, 1977

Mr. E. T. Barrett, II, Project Director
Interagency Task Force on Product Liability
U. S. Department of Commerce
Office of the Secretary
Washington, D. C. 20230

Dear Mr. Barrett:

We have reviewed the report of the Interagency Task Force on product liability which you were kind enough to provide in advance of its publication, and we believe it is an extremely useful discussion of the major issues. I should like to complement you, Professor Schwartz, the Department of Commerce, and the other members of the Interagency Task Force on a truly outstanding job of defining the basic problems and describing in a fair and balanced way the arguments on both sides of the various proposals and reforms which have been advanced.

We were pleased to see that the report recognized that some reform is required in the current tort litigation system. Although we believe the report does not go far enough in recommending reasonable limitations on the exposure faced by manufacturers under the current system, we were pleased that it does propose adoption of a number of reforms that would tend, in our view, to strike a more appropriate balance between the rights of those injured and the responsibilities of manufacturers.

As a member of the Advisory Committee to the Department of Commerce, I recognize my function was to submit views and data for consideration, and I have no responsibility for the conclusions and recommendations reached. Nevertheless, I want to note our disappointment and disagreement in two areas where we believe the Task Force reached conclusions which are unjustified. The recommendation that serious legislative consideration should be given to making Workers' Compensation the sole source of recovery in industrial accidents is ill-advised when coupled with the suggestion that, before this change

could occur, there would have to be a substantial increase in benefit levels. An overall increase in the level of Workers' Compensation benefits to assure adequate recovery to the small percentage of those injured who might have had a viable negligence claim against a third party is clearly an unsound and grossly uneconomic method of compensating workers for the loss of their right to bring third party actions. The recommended solution would involve not only a pointless shifting of insurance costs from third parties to employers, but also a significant overall increase in costs.

We were also disappointed with the Task Force's apparent lack of practical understanding of the impact of claims for punitive damages in product liability actions. The study concluded that there were no data indicating that punitive damages had any substantial impact on liability insurance rates. Although we recognize the data are difficult to collect, the fact is that the mere existence of punitive damage claims results in pressure for higher settlements and frequently prompts juries to increase their awards of compensatory damages, even though no punitive damages are awarded. Claims for punitive damages are becoming more and more commonplace in product liability suits. We believe that, if the Task Force had recognized the significant influence which these claims have on overall costs, it would have seriously questioned the concept that permits private parties to gain a windfall at the ultimate expense of consumers generally.

Sincerely,

F. G. Secrest

PRESIDENT
CHARLES W. STEWART

VICE PRESIDENTS
MELVIN C. HOLM .....Chairman
Carrier Corporation, Syracuse, New York
HUGH D. LUKE .....Chairman
Reliance Electric Company, Cleveland, Ohio

TREASURER
THOMAS F. RUSSELL .....Chairman
Federal-Mogul Corporation, Detroit, Michigan

SENIOR VICE PRESIDENT
CHARLES I. DERR

VICE PRESIDENT AND SECRETARY
RICHARD R. MacNABB

ASSISTANT TO THE PRESIDENT
FRED E. SHAND

ASSISTANT SECRETARY
PAUL H. PRATT

STAFF COUNSEL
WILLIAM J. HEALEY, JR.
DONN R. MARSTON
FRANCIS W. HOLMAN, JR.

ECONOMIST
A. B. van der VOORT

ASSISTANT TREASURER
MILDRED SMITH

EXECUTIVE COMMITTEE
JOSEPH T. BAILEY .....Chairman
The Warner & Swasey Company, Cleveland, Ohio
BERNARD J. BANNAN .....Chairman
Western Gear Corporation, Lynwood, California
JAMES F. BERE .....Chairman
Borg-Warner Corporation, Chicago, Illinois
JOSEPH A. BOYD .....President
Harris Corporation, Cleveland, Ohio
JOSEPH D. BRENNER .....President
AMP Incorporated, Harrisburg, Pennsylvania
WILLIAM S. BREWSTER .....Vice Chairman
Emhart Corporation, Farmington, Connecticut
ROBERT CIZIK .....President
Cooper Industries, Inc., Houston, Texas
W. PAUL COOPER .....President
Acme-Cleveland Corporation, Cleveland, Ohio
CLARK DAUGHERTY .....President
P. R. Mallory & Co. Inc., Indianapolis, Indiana
E. M. de WINDT .....Chairman
Eaton Corporation, Cleveland, Ohio
E. B. FITZGERALD .....Chairman
Cutler-Hammer, Inc., Milwaukee, Wisconsin
DONALD A. GAUDION .....Chairman
Sybron Corporation, Rochester, New York
EDWARD J. GIBLIN .....President
Ex-Cell-O Corporation, Troy, Michigan
CHARLES F. HAUCK .....President
Blaw-Knox Company, Pittsburgh, Pennsylvania
JOHN V. JAMES .....Chrm. and Pres.
Dresser Industries, Inc., Dallas, Texas
JOHN JEPPSON .....Chairman
Norton Company, Worcester, Massachusetts
DAVID T. KIMBALL .....President
Leeds & Northrup Co., North Wales, Pennsylvania
ROBERT V. KRIKORIAN .....President
Rexnord Inc., Milwaukee, Wisconsin
J. PAUL LYET .....Chairman
Sperry Rand Corporation, New York, New York
ROBERT H. MALOTT .....Chairman
FMC Corporation, Chicago, Illinois
HARRY C. MOORE .....Chairman
Beloit Corporation, Beloit, Wisconsin
BRUCE F. OLSON .....Chairman
Sundstrand Corporation, Rockford, Illinois
JOHN R. PARKER .....President
A. O. Smith Corporation, Milwaukee, Wisconsin
LOUIS PUTZE .....President
Utility & Industrial Operations, Rockwell International Corporation, Pittsburgh, Pa.
ARTHUR J. SANTRY, JR. .....President
Combustion Engineering, Inc., Stamford, Connecticut
WALTER E. SCHIRMER .....Chairman
Clark Equipment Company, Buchanan, Michigan
HENRY D. SHARPE, JR. .....Chairman
Brown & Sharpe Mfg. Co., N. Kingstown, Rhode Island
RICHARD B. STONER .....Vice Chairman
Cummins Engine Company, Inc., Columbus, Indiana
HAROLD A. STRICKLAND, JR. ...President
General Signal Corporation, Stamford, Connecticut
R. J. WEAN, JR. .....President
Wean United, Inc., Pittsburgh, Pennsylvania
WILLIAM L. WEARLY .....Chairman
Ingersoll-Rand Company, Woodcliff Lake, New Jersey
JAMES W. WILCOCK .....Chairman
Joy Manufacturing Company, Pittsburgh, Pennsylvania
ROBERT C. WILSON .....Chrm. and Pres.
Memorex Corporation, Santa Clara, California
GEORGE G. ZIPF .....Chrm. and Pres.
The Babcock & Wilcox Company, New York, New York

MACHINERY and ALLIED PRODUCTS INSTITUTE
1200 EIGHTEENTH STREET, N.W. WASHINGTON, D.C. 20036 202-331-8430

November 10, 1977

The Honorable Sidney Harman
Under Secretary of Commerce
Department of Commerce
Washington, D.C. 20230

Dear Mr. Harman:

With MAPI staff assistance, I have just completed my review of the Final Report of the Interagency Task Force on Product Liability which you sent me upon the occasion of its publication. As a response to your invitation for comments, this statement includes both observations relating wholly to the Final Report and the reiteration--with revisions--of comments addressed to the Draft Final Report and set out in my letter of October 21. It is my understanding that these comments together with those of other members of the Advisory Committee on Product Liability will be published separately in the future.

An Overall Appraisal of the Report

As indicated in our comment on the draft version of this report, we think it a comprehensive and thoughtful examination of the subject. It is an important addition to the sum of knowledge on a matter of surpassing complexity --products liability. In eschewing recommendations the report does not go far enough in our view but, that aside, it lays a foundation for further study and necessary action. We extend our compliments to you and the staff of the Interagency Task Force for this contribution.

We note in passing that one practical--and beneficial--effect of the Final Report is to supercede the Task Force's "Briefing Report" issued on January 4, 1977. That report, composed and published in great haste, was--as I think you know--not well received by the industrial sector. Hence, we are pleased to see that at least some of the apprehensions and uncertainties created by the Briefing Report have been relieved by the final document. We believe that the Final Report should have expressly supercede the Briefing Report.

MACHINERY & ALLIED PRODUCTS INSTITUTE AND ITS AFFILIATED ORGANIZATION, COUNCIL FOR TECHNOLOGICAL ADVANCEMENT, ARE ENGAGED IN RESEARCH IN THE ECONOMICS OF CAPITAL GOODS (THE FACILITIES OF PRODUCTION, DISTRIBUTION, TRANSPORTATION, COMMUNICATION AND COMMERCE) IN ADVANCING THE TECHNOLOGY AND FURTHERING THE ECONOMIC PROGRESS OF THE UNITED STATES

The Report's Purposes

Two statements in Chapter I of the report relate directly to the purposes of the report and any appraisal of how well those purposes have been achieved. We are told at page I-1 that ". . . in April 1976 a Federal Interagency Task Force was established by the Economic Policy Board of the White House to study the product liability problems and report back to it on or before December 15, 1976." At I-2, the report says, "It is our hope that this report and our three independent contractor reports will be of assistance to the Administration and legislators, as well as to consumer, insurer and business groups and to others who are interested in a balanced and sound resolution of problems that have arisen in the field of product liability."

In brief, the Task Force conceived its responsibility to be that of determining whether in fact there is a products liability problem and, if so, to examine into the nature of the problem, its sources and possible solutions. Assuming a conclusion that a problem existed--a conclusion amply borne out by the report--in our view the assignment necessarily implied a search for solutions to the problem and specific recommendations directed to that end./1

Few, if any, specific recommendations are to be found in the report. Its conclusions are uniformly equivocal, drawn from that school of thought which avoids decision by saying "on the one hand--but on the other." It is discursive but not decisive.

Repeatedly, the report addresses its comments to "legislators," suggesting matters for their consideration but not recommending any particular course of action. Moreover, it emphasizes its equivocal tone by refusing to indicate whether state or federal action--or both--is preferable.

We believe the need for prompt action in this area is increased by the fact that a number of state legislatures on their own--which is acknowledged in the report--are moving to enact legislation relating to products liability containment. For obvious reasons, there will be no clear pattern or consistency with respect to such state action, although most if not all of such legislation that has been brought to our attention contains protective provisions limiting products liability on reasonable grounds.

1/ Indeed, the original charter of the Task Force can be read to require recommendations. The pertinent Federal Register notice of September 20, 1976, under "General Purposes of the Study," says "D. To determine what remedial actions may be necessary to alleviate burdens being imposed by the current system of compensation for accidents from the use of products."

What Remains To Be Done

We hope that you and the Department of Commerce, using the Task Force report as a reference source and a point of departure, will move swiftly to approve a recommendation to Congress on a package designed to at least mitigate the worst effects of the very serious products liability problem. Our views on the content of such a program were expressed in our statement before the Consumer Subcommittee of the Senate Committee on Commerce, Science, and Transportation on April 27, 1977. Although advanced as specific suggestions for consideration and not firm recommendations, since presenting that testimony we have had no occasion to change our views on the subject. An extra copy of our statement before the Senate Consumer Subcommittee is attached, including our April 25 analysis of a quick supplemental questionnaire to our original comprehensive survey. (No doubt the future printing of this letter will not include our statement to the Senate Subcommittee. However, we do hope that the text of the updating questionnaire can be included.)

As you know, several important legislative proposals concerning products liability are now pending in Congress. It is not likely that any such proposal will receive serious congressional consideration in the absence of an Administration recommendation. It seems to us that the Final Report of the Task Force provides a basis for specific legislative recommendations to solve a problem which continually worsens, and we hope that you and the Department of Commerce will take the lead in developing such recommendations.

General Comments

Our comments which apply to the report as a whole appear below. Other comments, applicable to the insurance aspects of products liability or to possible changes in tort law, follow.

The origin of the problem.--At page I-1 we are told that "In 1975, an apparent problem (some sources said 'crisis') arose in the field of product liability." The clear implication is that the problem first surfaced in 1975. This is quite wrong and thus misleading. The Institute has been continuously concerned with products liability since the November 1960 meeting of its Insurance Council and, in 1966, held a heavily-attended seminar on the subject in New York. We acknowledge that by footnote the evolving nature of the problem is recognized. However, the footnote is buried and the body of the text at this point remains unchanged.

Moreover, the Final Report itself contradicts this unfortunate misimpression. The Greenman case, which first adopted the theory of strict liability, was decided in 1963 and in 1965 The Restatement (Second) of Torts embraced strict liability in tort in the promulgation of Section 402 A thereof. (See page II-5 of the Final Report.) Finally, at page VII-15

of the Final Report we learn that "There has been over 10 years of intense litigation in the area of product liability since the publication of Restatement (Second) of Torts, Section 402A."

Products liability and small business.--Frequently, in referring to some aspect of products liability, the Final Report speaks of it as "particularly affecting small business," or words to that effect. The problem is very serious for small business but it is also very serious for business of all sizes. It is a general problem affecting a major portion of American business and industry regardless of its size, and we think the report should have emphasized the generality of the problem.

"Anecdotal data".--The report contains frequent references to "anecdotal data" which is nowhere defined but presumably means a casual and unsystematic body of information characterized in part by the relation of individual experiences or "anecdotes." Whatever the authors' intent, it is clear that they place little or no reliance whatever on anecdotal data as a basis for action to reduce or overcome the products liability problem.

Acknowledging that anecdotal data may not be conclusive, surely it is suggestive and it may at least be used to corroborate more comprehensive and statistically sound information. The apparent refusal even to consider the signals sounded by "anecdotal data" suggests to us the possibility of studying this subject interminably while industry is damaged irreparably.

This attitude bothers us even more when we compare certain of the statistical results of the recent ISO Product Liability Closed Claim Survey with comparable data in the Final Report. Pages II-43 through II-53 of the report are devoted to "An Independent Survey of Product Liability Appellate Cases In Selected States." In the summary on page II-51, we learn that "The lowest awards were made, on the average, in Illinois." Contrast this with ISO's Table 2-1, BI (Bodily Injury) only on "Distribution of Payment By State"/1 which shows that the average claims payment in Illinois was $51,084 or some four times more than the $12,519 average in California and in which state, according to the Final Report, "the highest damages were awarded."

Admittedly, we are comparing horses and horse chestnuts--the Final Report is concerned only with judicial awards, the ISO report with closed claims of which judicial awards are only a small part. However, it is paid claims and not solely judicial awards which influence insurance rate-making and thus the ISO figures are the decisive ones. The uninformed reader would be likely to get an altogether misleading impression from reading the "independent survey" figures alone.

1/ Covering closed claims, as defined, from July 1, 1976 through March 15, 1977.

Our recital of this comparison--or contrast--is not intended as a criticism of the Final Report itself but rather to illustrate our reaction to the authors' disdainful dismissal of "anecdotal data." Such data, we contend, has value but it must, of course, be used with judgment and discretion as--obviously--is also the case with data which appear to satisfy the authors' standards for usable statistics.

Motivation.--The report makes frequent reference to the use of existing laws or suggested remedies in motivating management to limit products liability exposure by a variety of means such as improved quality control, better control of design procedures, etc. Moreover, it implies insufficient employer interest in maintaining a safe workplace and minimizing injuries. I know of no MAPI member company--a wide and varied constituency--which has not had for a very long time a high priority on safety in the workplace and this without reference to any pertinent federal regulation. No doubt additional motivations toward reduction of product accidents can be achieved, but we think the report copy on the point is overdone because it implies the existence of a condition at variance with reality.

Worker-caused accidents.--There is clearly inadequate treatment of the extent to which individual workers in the workplace cause accidents and sometimes very serious injuries by their own negligence and/or deliberate failure to follow clearly stated instructions and procedures considered to be mandatory by the employer. There is a human element in the products liability problem and no matter how conscientious the employer, employee behavior counts for a significant aggravation of the products liability situation.

Contingent legal fees.--We think the report is too "soft" on contingent legal fees. It argues that such fees which appear to be exorbitant are necessary as an offset to "no fee" cases where plaintiff does not prevail. The experience of the MAPI membership suggests that the argument is specious.

We have no desire to criticize the plaintiffs' bar in general but information available to MAPI suggests that plaintiffs' counsel are being generously rewarded, if not over-rewarded, for cases won in court or by settlement. We are convinced that this is a key problem in products liability, but the report's comments on the point appear to consist mainly of a rationalization and as acceptance of the status quo.

"Product Introduction and Discontinuation".--Under this caption at page VI-44, we are told that "Product liability problems in the pharmaceutical and other high-risk product lines may reinforce trends against new product development with the result that some socially beneficial products may never be developed or may be discontinued." Somewhat later the report says, "This is an area that deserves further investigation."

We agree, of course, but in the hope of stressing the crucial importance of the matter, we want to add a bit to the report's observations. In last year's MAPI survey we asked this question:

> Have you any evidence that the upsurge in products liability claims has inhibited the development of new products or the discontinuance of an existing product or product line within your company?

The question was answered by 206 companies of which 33 or 16 percent said "yes." Several other companies indicated that this aspect of the problem was receiving serious consideration although no action had yet been taken. One comment is especially significant and hence is repeated here: "Present research expenditures are being allocated towards areas of less exposure to consumer and liability problems."

"Socially beneficial" products may not only die stillborn because of products liability--the tentative conclusion of the report--but important new technologies, an important source of new capital investment and the generation of new economic activity, may also be throttled. It is this latter and broader effect on the economy which deserves "further investigation."

"Basic Considerations in Evaluating Remedies".--Chapter VII of the Final Report at page VII-2, et seq, identifies six considerations employed by the Task Force in its evaluation of proposed remedies. Ignoring quibbles over language, we think them useful even though, to some extent, they "establish conflicting goals." We think one further consideration must be kept in mind in evaluating remedies: Having due regard for the rights of all interested parties, we should seek always to reduce the volume of litigation. It may be that this further consideration was intended to be included as part of "Consideration V" (page VII-6), but we doubt if that intent--if such is the case--will be apparent to every reader.

Comparative negligence.--A reading of the whole of the Final Report reflects, in our judgment, a clear bias--sometimes clear and sometimes veiled--in favor of the doctrine of comparative negligence. We express no opinion on the desirability of applying comparative negligence except to say that the acceptance of this approach is not without opposition.

Our objection to this evidence of bias stems from what seems to us a palpable deviation from an otherwise consistent policy of abstaining from remedial recommendations. A similar bias, although not perhaps so apparent, seems to favor arbitration, particularly mandatory nonbinding arbitration. Again, we reserve judgment but we observe in passing that we are not at all sanguine about the possibility of nonbinding arbitration achieving any significant reduction in the volume of products liability litigation.

"Balancing the equities".--In our opinion the report tries too hard for perfect equilibrium in its obvious attempt to "balance the equities." As in the case of frequently conflicting national goals, it is difficult, and sometimes impossible, to achieve a complete reconciliation or balance. And so it is with products liability. To the extent it can be done without straining we should, of course, balance the equities but the critical need in products liability is an answer and not a balance. If action is postponed until that state is achieved, we may never solve the products liability problem.

Target groups.--For the record, and upon the basis of the Institute's rather considerable experience in the field, we believe that "target groups" of industries selected for the industry contractor report are too limited in terms of the breadth of the total problem. To some extent at least the result is incomplete data and thus an incomplete picture of the seriousness of the problem across industry.

Insurance

Comments relating to the insurance aspect of the Final Report appear below.

Proposed remedies and premium reductions.--Repeatedly, in discussing a possible remedy the report indicates that insurance industry representatives do not believe that adoption of this proposal would affect products liability insurance premiums or, at least, the insurance industry would want to "wait and see." We have no doubt these reactions are accurately reported. We are not so sure that they should be unhesitatingly accepted as appears to have been the case.

It seems to us that the insurance industry's reaction is altogether predictable--a posture of reserving to itself all possible options. In short, one doubts if the insurance industry is completely objective in viewing possible results of potential remedies--nor could objectivity be expected. We believe that adoption of certain of the solutions discussed in Chapter VII, over time and if properly implemented, would almost surely lead to rate reduction. Moreover, the report makes the point that the insurance rate structure has not been properly rationalized. If that is true, and we agree that it is, how can the insurance industry now be so certain that a particular solution or combination of solutions would not affect the rate structure significantly?

Reduced coverage.--On page VI-43 this statement appears: ". . . insurance companies are not forcing insureds to retain more risk by reducing the amount of coverage that they are willing to make available." Two paragraphs later, we learn that, ". . . the levels of deductibles appear to have increased significantly. . . . This increase in the frequency and level of deductibles may be a matter of choice on the part of insureds rather than a requirement of the insurance companies." (Emphasis supplied.) It is also very possible that they may not be a matter of the insured's

choice, and our experience suggests that the latter possibility is the more likely one./1 We think the two statements quoted above are inconsistent with one another and that the first tends to mask a serious reality for many industrial companies.

Self-insurance.--In an otherwise useful discussion of self-insurance at pages VII-135 and 136, we see no mention of Financial Accounting Standard No. 5 which appears to prohibit the booking of contributions to self-insurance reserves. We feel sure that any solution of the character intimated in this discussion must consider this rule of the Financial Accounting Standards Board.

Captive insurance companies.--Beginning at page VII-124, the report's discussion of captive insurance companies is incomplete--perhaps because of the time when it was written. The fact is that Internal Revenue Service Ruling 77-316 seriously and adversely affects the use of captive insurance companies as a device for enlarging the products liability insurance market. One may infer from this discussion that federal legislation would necessarily solve the problem created by this Revenue Ruling. However, state legislation would not produce that result and, as noted above, the report makes no recommendation concerning federal versus state legislation.

Tort Law Reform

Workers' Compensation As a Sole Source of Recovery in Workplace Accidents.--In our view, the discussion of this proposal is well done with one exception. The report assumes that if workers' compensation were made the sole remedy in workplace accidents that some quid pro quo replacing the injured worker's present right to sue would be required. If the single remedy were adopted, no doubt compensation awards in several states--perhaps most--would have to be increased to permit a more liberal scale of awards. Insofar as any state's schedule of workers' compensation benefits is obsolete, it should be corrected in any event.

We do not agree with the report's conclusion that a manufacturer whose product is involved in a workplace accident "should contribute to the worker's award." Moreover, admitting that it is an arguable proposition, we also do not agree that there is any absolute legal requirement for an explicit quid pro quo if it is determined as a matter of national policy that the single remedy approach is sound in theory and serves the public interest. History is replete with cases in which a private interest has been subordinated to a larger public purpose.

With reference to a closely related proposal concerning workplace accidents, we do not believe that conformity with OSHA standards as a basis

1/ Participants in the MAPI survey were asked "Does your products liability insurance carrier require acceptance of a deductible or large retrospective retention?" Of 205 companies answering the question, 77 or 37 percent said "yes."

for any such solution is appropriate. Those standards are subject to legal contest in some cases. They are not designed in the products liability context. And we can envisage many situations where a standard may have been violated but where such violation was not the cause of the injury.

"Open-ended" strict liability.--In its discussion on pages VII-14 and 15 of basic standards of responsibility for products liability, the report says:

> When the product is not made in accord with the manufacturer's own specifications (a defect in construction) and this causes injury, manufacturers should be strictly liable. On the other hand, when the defect is one of design or failure to warn, it may not be sound to subject a manufacturer to liability unless considerations such as the foreseeability of harm and the seriousness of harm are balanced against the utility of the product and the burden on the manufacturers to avoid the risk. In sum, open-ended "strict liability" under the tort system in these areas does not appear to be sound long-range policy.

We have quoted this passage to emphasize what we think is a very necessary distinction to be made between the proper and the improper application of strict liability. We agree with it and suggest that this very nice distinction should be considered for inclusion in any legislative program such as we have already recommended.

A procedural matter.--You and I have corresponded regarding the utilization of the Advisory Committee to the Department of Commerce on product liability. Without going into any detail in this communication, we feel obliged to reiterate our feeling that particularly with reference to the Draft Final Report, the advice and counsel of the Advisory Committee were not sought in a meaningful manner.

This concludes our comments on the Final Report of the Interagency Task Force on Product Liability. We appreciate this opportunity to comment and if the Institute or its staff can be of any assistance to the Task Force, we hope you will not hesitate to ask.

Very truly yours,

Charles Stewart

President

Enclosure

ELI LILLY AND COMPANY

INDIANAPOLIS, INDIANA 46206

RICHARD D. WOOD
CHAIRMAN OF THE BOARD

November 14, 1977

The Honorable Sidney Harman
Under Secretary of Commerce
United States Department of Commerce
Washington, D. C. 20230

Re: Interagency Task Force
on Product Liability

Dear Dr. Harman:

I am in receipt of your letter dated October 13, 1977, and enclosed draft of the Final Report of the Federal Interagency Task Force on Product Liability. In the time allowed, the following comments can only be considered our initial reactions:

1. The findings and conclusions with regard to the rating and underwriting practices of the insurance industry appear to present a generally accurate picture as they relate to our company. We have experienced a significant increase in the cost of products liability insurance in recent years, and we are now unable to obtain coverage on some of our products, both pharmaceuticals and agricultural chemicals, at any cost. It is a harsh reality that the rising insurance costs ultimately will be reflected in the prices consumers pay for products and in a reluctance to develop and market useful products.

2. Although I am advised the Final Report fairly summarizes the current body of products liability law, we are not in agreement with the analysis of certain proposed modifications in tort law. In particular we disagree with the conclusion that

> "[i]f a consumer was injured by a defect that was present in the product at the time it was sold (e.g., a long-term risk from a pharmaceutical) but that did not manifest itself until after ten years, the manufacturer should be subject to liability for the injured party's actual economic losses."

We do not believe pharmaceuticals should be excepted from the operation of a "date of sale" statute of limitations for the following reasons:

A. Generally, the primary purpose of a statute of limitations is to require an injured person to initiate a lawsuit within a reasonable period of time so that a defendant has a fair opportunity to defend. Statutes of limitation are, by their very nature, arbitrary but practical devices needed to relieve the courts from litigation involving stale claims and to spare defendants from defending lawsuits after memories have faded, witnesses have disappeared or died, and evidence has been lost. As a result of judicial activism in the law of products liability in recent years, the rule of law emerging today allows an injured person to sue a manufacturer in perpetuity. This rule of law contravenes the very purpose of a statute of limitations and is patently unfair. Regardless of the merits of any lawsuit, a point in time is eventually reached at which it does not serve justice to subject <u>any</u> product manufacturer to the defense of a stale claim. In this connection, it should be noted that the mere fact of injury does not establish that a claim is compensable or meritorious. There are many other issues which must be resolved against a product manufacturer before a claim can be said to be meritorious. Thus, claims which would be barred under such a statute of limitations may not be meritorious.

B. Specifically, the vast majority of injuries which result from the use of pharmaceuticals are discovered within three years from the date of sale. In addition, the pharmaceutical industry is subject to an extremely comprehensive scheme of federal and state governmental regulation that substantially decreases the likelihood of the existence of large numbers of meritorious claims which would be barred by such a statute of limitations. Because pharmaceuticals must undergo extensive testing in laboratory animals and in humans before they can be approved for marketing, there is a high degree of predictability of the risks involved with the use of any pharmaceutical product at the outset.

C. Finally, it should be noted that "date of sale" statutes of limitations for products liability actions (including actions concerning pharmaceutical products) have been enacted in other states. See, e.g., Fla. Stat. Ann. § 95.031(2) (1975); N.C. Stat. Ann. § 1-15 (1971); Connecticut Public Act No. 76-293, an Act providing for a statute of limitations on strict products liability, approved June 4, 1976; Ore. Stat. Ann. § 12.115(1) (1967); see also 369 Prod. Liab. Rptr. ¶ 3420 (Aug. 19, 1977) (newly enacted Oregon law, effective Jan. 1, 1978).

Also, in its discussion of a proposed defense based on the state-of-the-art, the Final Report concludes:

> "It would be inadvisable for product liability law to adopt a state-of-the-art defense based on the standard customarily utilized in the industry."

The Final Report correctly assumes it is inequitable to judge the manufacturer of any product by current technological standards if the product conformed with technological standards prevailing on the date of manufacture. This inequity is particularly apparent when such a standard is applied to the pharmaceutical industry. As previously mentioned, the pharmaceutical industry is subject to an extremely comprehensive scheme of regulatory law. Compliance with this body of regulatory law as well as the prevailing technological standards in the industry on the date of manufacture greatly minimizes the likelihood of injuries flowing from use of a pharmaceutical product.

Moreover, the Final Report does recognize that "courts that deem technological state-of-the-art irrelevant fuel the uncertainty in product liability law that has helped bring about a problem." However, the Final Report suggests that the state-of-the-art defense be measured by additional standards that include the amorphous concepts of "technology available" (but not used) and "cost and practicability of alternative design approaches" (but not used). This interjects unrealistic tests that would eviscerate the state-of-the-art defense.

It is our opinion that the Final Report's findings and conclusions in connection with the above proposed

tort modifications are incorrect. While further study may reveal other opinions expressed in the Final Report which are questionable in our judgment, those opinions discussed and criticized appear at first reading to be the most significant.

I would like to commend the members of the Task Force and the Advisory Committee for their thoughtful efforts in analyzing one of the gravest problems confronting industry today.

Sincerely,



Part II: Product Liability Symposium

In order to generate new ideas and perspectives about product liability problems and solutions to those problems, the Working Task Force conducted a symposium in July 1976. The participants included the Reporter of the Restatement (Second) of Torts, an author of one of the leading casebooks and treatises on the topic of product liability, an acknowledged academic expert on the topic of insurance, a leading expert on no-fault compensation systems, experienced plaintiff and defense attorneys, a government economist, and professors of engineering and economics.

The symposium itself was divided into two parts. During the morning session, each of the participants made a brief presentation on a subject related to product liability and his or her field of expertise. During the afternoon session, each speaker had the opportunity to comment on the remarks of the other speakers. Following that discussion, members of the Working Task Force and other government staff persons were invited to ask the participants questions about their presentations or other aspects of the product liability problem.

The transcript of the symposium appears below in edited format.*/ The Working Task Force considered this transcript to be a valuable research document since it presents the views of ten of the foremost experts on product liability in the United States. Also, it presents an interesting diversity of views on product liability problems and their solutions.

The names of the participants are listed below at the beginning of the transcript. Their affiliations and background are set forth in the transcript in Professor Schwartz's introduction to each speaker's morning presentation.

---

*/ Citations to the Symposium transcript in the Final Report refer to the page numbers of the unedited version. In order to facilitate cross-references with the Final Report, those original page numbers are indicated parenthetically in the edited transcript.

TRANSCRIPT OF PROCEEDINGS

U. S. DEPARTMENT OF COMMERCE

- - -

- SYMPOSIUM ON PRODUCTS LIABILITY -

THE INTERAGENCY WORKING TASK FORCE

ON

PRODUCTS LIABILITY

- - -

Washington, D. C.
July 21, 1976

Pages 1 thru 100

U. S. DEPARTMENT OF COMMERCE

- SYMPOSIUM ON PRODUCTS LIABILITY -

THE INTERAGENCY WORKING TASK FORCE ON PRODUCTS LIABILITY

Room 4833,
Commerce Building,
Washington, D. C.
July 21, 1976

BEFORE:

PROFESSOR VICTOR SCHWARTZ, Chairman

GUEST SPEAKERS:

PROFESSOR JOHN W. WADE
Vanderbilt University
School of Law
Nashville, Tennessee

DR. NINA CORNELL
Senior Economist
Council on Wage and Price Stability
New Executive Office Building
726 Jackson Place
Washington, D. C.

MR. RICHARD M. MARKUS
Spangenberg, Shibley, Traci, Lancione, & Markus
1500 National City Bank Building
Cleveland, Ohio

GUEST SPEAKERS (CONTINUED):

PROFESSOR JEFFREY O'CONNELL
University of Illinois
Law School
Champaign, Illinois

PROFESSOR WALTER OI
Chairman, Department of Economics
University of Rochester
Rochester, New York

PROFESSOR DOUGLAS OLSON
Associate Professor of Insurance
University of Pennsylvania
Wharton School of Business
Philadelphia, Pennsylvania

PROFESSOR JERRY PHILLIPS
University of Tennessee
College of Law
Knoxville, Tennessee

MR. WILLIAM WALLACE
Thompson, Hine, and Flory
1100 National City Bank Building
Cleveland, Ohio

PROFESSOR ALVIN S. WEINSTEIN
Department of Mechanical Engineering
Carnegie-Mellon University
Pittsburgh, Pennsylvania

ALSO PRESENT:

RICHARD WALSH
Department of Transportation

JAMES VAN HORNE
Treasury Department

DAVID McNICOL
Council of Economic Advisors

HOWARD CLARK
Federal Insurance Administration

ELI BERNZWEIG
Federal Insurance Administration

- - -

P R O C E E D I N G S

CHAIRMAN SCHWARTZ: This Task Force is approaching a problem that is, at least as far as we can tell, of substantial importance to many people in the United States; to industry, to consumers and to employees in terms of whether they are injured in the work place or in terms of whether they continue to have employment after the so-called products liability crisis gets worse.(p.6)

Many, many companies have told us and tried to show us that they are either unable to obtain product liability insurance or. that the rates that they are being charged are so great that they can see shortly down the road when they will not be able to continue in business.

We don't have the data base right now to see how widespread this alleged crisis is. That is part of our task. But assuming that it is fairly widespread, we have to decide what changes, if any, should be made in the law.

To provide just a very short framework for these changes, they can be looked at under rather functional headings. The changes in law can be made at the state level and they can be made within the framework of the existing tort litigation system.

Most of the proposals that have come to us have called for modifications in three areas. First, there is changing of the law regarding defenses. An example would be modifying a statute of limitations to operate from the time of sale of a product rather than from the time it injures a person. Second, there is a call for modifications in the area of damages. An example would be putting a strict limit on the amount one pays for pain and suffering. Third, there is a call for modification of the rights of third parties against one another. An example would be allowing a manufacturer of a product that injures a person in the work place to sue an employer who had already paid a worker workmen's compensation benefits.(p.7)

The other line of reform is also at the state level and calls for modifications in insurance law: the creation of assigned risk pools; the creation of joint underwriting associations; state involvement in re-insurance.

Finally, at the state level, some say that tinkering with the tort litigation system simply will not work and that no-fault compensation systems are the answer. No-fault means many different things to many different people, as we will see here today.

We want some insight into no-fault systems, how they might work in the products liability area.

Finally, there are those that say that changes in products liability law cannot be effective at the state level; that a crazy-quilt pattern of 50 different laws regulating products presents an overwhelming burden for commerce and therefore, in spite of all the problems that sometimes flow from it, Federal action is necessary.

This could be in many forms. This could mean a Federal tort law; this could mean a Federal no-fault system; this could mean Federal involvement in products liability insurance.

Our guests will today focus on some of these approaches and maybe some others that haven't been stated. Their presentations will be relatively short because I know that members of the various agencies that are here today have some questions for them.(p.8)

This afternoon, we will hear from some members of our own Task Force.

Our first two speakers may speak a bit longer than some of the others because they are in a position to provide an overview of this mysterious field that we call products liability.

Our first speaker, John Wade, is perhaps in the best position in this nation to give that overview.

Since 1970, he has served as Reporter for the Restatement of Torts. He is the author of the leading case book on torts in the nation. He has written perhaps as many articles in the field of products liability as any other person alive today. And he also somehow has done all this while serving 20 years as the Dean of Vanderbilt Law School. And it is almost impossible, people say, to be dean of a great law school and contribute productive scholarship at the same time.(p.9)

We are pleased to have John Wade here today to speak to us.

John?

MR. WADE: Thank you.

There is a statement that businessmen make sometimes about lawyers to the effect that they always tell you why you can't do something, never what you can do; and maybe to a certain extent, that is what I am going to do now. I don't come to you with any automatic solutions that are going to take care of the problem. (p.10)

It occurs to me here that there might be some help in organizing and indicating that there are about four areas in which something might be done:

The first is to make the product safer, to prevent the accident. And it seems to me that this is where most of the emphasis might well be placed. This is perhaps an area in which the Federal Government may be able to do more than in some of the other areas.

This is where it ought to start. If we can stop the accidents, stop the injuries, why we have taken care of the major problem. And there are ways in which government may assist and participate here.

Another approach, another field, another area, involves a change in the system entirely. There is no-fault insurance -- and we will have occasion to go into this -- that is first-party insurance. That is a situation in which the injured party carries his own insurance. There is no-fault liability, which is an entirely different thing. That is the situation in which the manufacturer or the producer of the product is responsible without any need to find any fault on his part or any fault in regard to the nature of the product. Be careful as you listen to what is being said here that you don't come into confusion between these two "no-fault" ideas.

There is arbitration; and arbitration will always be considered in these matters. It could take over entirely; it could be available in certain fields.(p.11)

The third major approach has to do with treatment of the insurance aspect.

And the final one has to do with changes in the tort system, changes that may be substantive or procedural.

Now, as you know, there has been a growing effort towards adopting no-fault insurance. This is automobile accident reparations. I thought a reference to why it was being pursued might be of importance as we think of the tort aspect.

The goal of the tort system has been to obtain an individualized treatment of each case, with due consideration for its particular circumstances. Now, the purpose of this has been to make sure that fair treatment is given to both parties. But this approach takes time. And it involves quite a number of difficult decisions, decisions involving the exercise of judgment and discretion.

This has been the boast of the common law. This has been the most important aspect of the tort law in this connection; but it has some problems too. It is expensive; it takes time.(p.12)

Now, the goal of the No-Fault Insurance Act was to eliminate the discretionary decisions, to make the determinations more or less automatic, or as near to that as possible. Thus, a trial may well not be necessary. And if there was a trial, it would be short; it wouldn't take much time. Thus, sometimes, with increasing frequency perhaps, according to this goal, an attorney would not be necessary. The individual would be able to handle it himself.

The indication was that this would come into something more or less like fire insurance, first-party insurance. You insure your own house and if your house burns down, the insurance company normally pays for it and you have a little bit of negotiation, of confirming, but you don't have to have a trial. But of course that total goal could not be obtained. But there was a considerable amount of moving toward it in the Automobile Reparations Act.

Now, I would indicate to you that in the field of products liability I think that goal is not attainable and should not be attained; but it seems to me it may be of some importance to look in the products liability field to discover where these discretionary judgments decisions need to be made, with the idea of determining how far they need to be kept discretionary and how far they might be decided somewhat ahead of time, according to a rule, or something of that sort. How far can we simplify the system and maintain what we ought to have?(p.13)

In the field of tort liability, what we have is a system in which the injured party is suing the party -- the defendant, proving that there is a basis for having the defendant pay the injured party for the injury; and ordinarily that is done by use of third-party insurance, a liability insurance policy.

The bases for liability for determining when there will be a shifting of the loss from one party to the other in this area are perhaps three:

One is negligence, that the defendant, the manufacturer, did not act as a reasonable, prudent person in regard to the manufacturing of the product. A second is breach of warranty, that the product as it was put out was not of suitable quality, that it was dangerous in some way. And a third one, the most important one that has developed in connection with the so-called strict liability in connection with manufacturers, is that the product was defective or unreasonably dangerous. Under this approach we are changing the fault aspect primarily from the defendant himself to the product; is the product one that is unreasonably dangerous?

It is possible to take the attitude you don't have to have the product unreasonably dangerous. It is possible to say you will do that. But I don't think it can be worked out in any full sense of the term.(p.14)

If you said, "If a product causes injury, then there is liability," what would you do with the match manufacturers? Every time a fire was started with a match and something burned, there would be liability for it.

What would you do with the automobile? Every time an automobile damaged somebody, the manufacturer would be liable for it. We have just decided that's impossible; we can't go that far; and so we have some other basis for determining when the manufacturer is liable; we have not gone to the point of saying any injury arising out of the product in any respect is something for which the manufacturer will be liable, because he is in a position to spread the loss.

My own viewpoint is, in connection with the basis for the liability, that the concept of being unreasonably dangerous is the best way to approach this. Not all courts have followed it. Some courts have talked about a defective product alone and have not indicated that it needs to be unreasonably dangerous.

There are certain dangers that simply cannot be eliminated and have the product to accomplish what it is prepared to accomplish. And so you run into the question of whether it is unreasonably dangerous. But that is a decision then that takes time and takes effort. You can't avoid making that decision.(p.15)

It is possible, under certain circumstances, to have a determination ahead of time and you don't have to individualize each particular channel. For example, we may have the determination as to whether blood plasma is unreasonably dangerous if it has hepatitis germs that can't be discovered. That is a general policy decision that might be made once and for all.

The second field in which there are decisions is in the area of causation.

Now here, in connection with automobile accidents, there weren't so many problems. If there was a collision, you didn't want to worry about whether it was caused by this automobile or not. But in connection with products liability there are important decisions that have to be made.

What about the condition of that article? Was it in that condition at the time it left the manufacturer? Did it arise at a different time? That's a fact question. And that is a decision that has to be made by the judge or the jury after hearing the individualized evidence. That I think we can't transfer to someone else.

The third area in which there are decisions is in the area of damages. And here it seems to me that there may possibly be some development.(p.16)

In damages there are certain types. There is the physical harm to the individual or the physical harm to the property which is damaged. If it is to the individual, there is his economic loss, his doctor's bills, his loss of weight. Those can normally be calculated pretty well. There is the matter of pain and suffering. And there is the matter of economic loss in the sense of not being able to accomplish what you had expected to be able to accomplish because of what the product should have been. That is essentially loss of bargain; and that may not be, I think, in a tort action. It ought to be treated primarily as a contract action.

If there is a serious injury, I think that there can be some very difficult problems in assessing the damage. The customary way at common law and in most of the states today is to give a lump sum award. In doing that, the decider is speculating about what may happen in the future. And in speculating about what may happen in the future, he is going to make these judgments primarily for the injured party.

There is developing a thought that in this area it may be helpful to try to establish not a lump sum damage when there is serious harm, but one payable in installments. This can involve some difficult problems, but it can solve some very serious problems too.(p.17)

In the first place, it is very difficult to make a determination as to how long the injured party is going to live. If you wait to see, then you know precisely.

In the second place, there are questions about what you ought to do about income tax. If this is involving a matter of lost wages, there is no deduction for the fact that this is taking the place of income; and one of the major reasons is that if you speculate into the future you have no idea what the individual's position would have been in the future: he might have married; he might have had more children; tax rates fluctuate up and down. Usually there is thought that if it is past wages that weren't paid that you may think of imposing it, because you can know precisely.

But to make that change carries with it a question of how you take care of the pain and suffering. Well, again, you know how long, you know how serious it has been during that period. And that determination can be somewhat more effectively made.

If an approach in regard to this could be adopted, this is something which is not peculiar to products liability. This applies to the whole personal injury matter.(p.18)

One of the other things that I think needs to be done in this connection is to try to work out better standards, or standards at all, in connection with the evaluation of pain and suffering.

It is an anomaly, of course, to say that we give money for it. And I am sure that every one of us would have the attitude if we could get a better system, we would be a whole lot better off. But we haven't figured out anything to do except to provide the money aspect of it.

Nevertheless, -- well, first, if this goes to a jury, the jury is considering this ad hoc for this particular occasion. It has had no experience in this connection; it has no basis for assimilating it with other decisions. In England, they are trying to work out standards in this connection, to make it less erratic, less whimsical; and I think we need to do something in this regard if we can.

There are lots of people who have said, this is what we ought to do. And then when they try to figure out how to do it, they run into serious problems.(p.19)

The suggestion has been made that a determination of damages, at least in connection with pain and suffering, ought to be treated as a question of law, to be determined by the judge. Because it really is a policy decision. It is a determination -- not just the facts. It is a determination of what is a reasonable amount for this. And it may well be that if judges were to do this, they would be able to keep records, compare with each other, and be able to work out a sort of system that would be less whimsical. This is precisely what the English courts have tried to work out in this connection.

Their standards of recovery are somewhat less. I think our standards would still be higher; but to organize this and keep it from being whimsical I think would be pretty important.

Now, there is a problem here that needs to be mentioned. And this is the connection of the relationship of the recovery for pain and suffering, the relationship of it to the matter of the attorney's fees.

It has never been openly expressed, but to a fair degree, the contingent-fee system is based -- works in collaboration with a recovery for pain and suffering; and this interrelationship needs much more careful study.(p.20)

I think that some of the other fields in which study might be given would be in the area of statutes of limitation -- I personally don't see much that can be done there. The suggestion that it is within a period from the time of the original sale seems to me to be unfair. Often the injury doesn't take place for some time afterwards; and to hold that a statute of limitations has run against a man before he has been injured is simply not a system that anybody ought to be in a position of defending.

I will pass over the question of priorities; this is bound to come up; the question of the relationship between the several defendants; that is, the retailer, the wholesaler, the employer if the employee is injured. Those we can work with later.

I think I will stop at that and be ready to say something a little later.

CHAIRMAN SCHWARTZ: Thank you very much, John.

Our next speaker is a person who has combined substantial practice of law with substantial experience in the academic realm. He is an author of two of the leading books on products liability: a co-author, with Dix Noel of the University of Tennessee, of one law text that is used both by practicing lawyers and students, and the author of a casebook, a substantial work that was just published this May.

Welcome, Professor Jerry Phillips of the University of Tennessee.

MR. PHILLIPS: Thank you, Professor Schwartz, ladies and gentlemen.(p.21)

It is my understanding that we are convened here to consider possible legislative responses to what is understood to be an insurance crisis in the products liability area, not unlike that which faces the medical profession today. Therefore, anything we propose should be with an eye towards reduction of premiums for products liability insurance.

At the same time, we should bear in mind that nothing we propose should be offered as a solution unless it also has the primary purpose of furthering what we believe are the larger interests of society. If we can arrive at proposals which appear to serve those interests, our proposals should be recommended even though their insurance effects are unclear.

Any legislation we recommend, I believe, should be on a national rather than a state level, since many if not most of the companies we are concerned with operate on a multi-state basis, and varying intrastate enactments would probably do these companies little good in terms of insurance relief.(p.22)

I believe that federal legislation could be enacted under the authority of the Commerce Clause, since probably all products manufactured and sold today affect commerce within the broad ambit of that term, as it has been construed by the United States Supreme Court.

Such legislation might be made to apply to physical injury to personal property resulting from the transfer by sale, lease, gift or otherwise of unreasonably dangerous goods, and providing of such services in connection therewith.

The legislation would undoubtedly be subject to attack under the Equal Protection clause as well perhaps as on other constitutional grounds. There is of course no guarantee that it would withstand constitutional attacks, but there is respectful authority for believing that it would do so. As long as the constitutional issue is subject to reasonable debate, which I believe it is, the most we can do is propose leaving it to the courts to dispose by judicial decision.

One of the major areas of reform in connection with no-fault automobile liability insurance has been the elimination of recovery for pain and suffering and the elimination of double recovery under the collateral source rule. We may well want to consider importing these reforms into the area of product liability.

It has been contended that recovery for pain and suffering is an indirect means of providing for attorneys' fees in the contingency-fee system. Our society is committed to the contingency-fee system as a desirable way of providing legal services for those who might not otherwise be able to afford them.(p.23)

If the indirect means of supporting this system through pain-and-suffering recovery is eliminated, then the direct award of attorneys' fees should be considered as an alternative. Such a direct award could be placed under the supervision of the court and could thus be made more rational and less subject to abuse.(p.24)

Another consideration is whether the elimination of recovery for pain and suffering would result in a substantial number of worthy claims not being presented because of inadequacy of the amount involved from the attorney's point of view.

Alternatively, it may be desirable to provide for an award of reasonable attorneys'fees in the discretion of the court, whether or not the asserted claim involves a large amount; and indeed whether or not the claim results in a plaintiff's verdict, as long as its assertion appears reasonably meritorious in the eyes of the court.(p.24)

An item of recovery and related to that of pain and suffering is loss of consortium, which can well be eliminated because it is unnecessary. If a spouse is forced to lose work or to hire substitute help as a result of an injury, these items of damage are properly compensable. But recovery for loss of companionship is too speculative and provides too ready a means for the jury to return retributive awards in a system that should be based on compensatory awards.

Elimination of the collateral source rule could require reductions from awards of such items as health and life insurance and unemployment benefits, tax savings and the like. In addition, such a change should logically sweep within its scope the deduction of workmen's compensation benefits and concomitantly the elimination of employers' subrogation rights in this regard.

A related proposal would be to provide that where workmen's compensation benefits are available, this should be the exclusive remedy for an injured employee. If such a proposal were enacted, it should only be enacted together with provisions increasing the scope and coverage of states' workmen's compensation benefits, which presently are clearly inadequate.

Any proposal to make workmen's compensation benefits an exclusive remedy for the injured employee runs into the problem of eliminating the incentive to make a safer product, which tort liability is thought to encourage. No one can be sure to what extent such liability actually induces greater safety measures, but in the absence of conclusive data one way or the other, it seems wiser to assume that potential liability does provide such an incentive; therefore, to foster the incentive it would probably be desirable to provide the employer with an action over against the manufacturer or seller on a degree-of-fault basis in those situations where the unreasonably dangerous conditions can be traced back in whole or in part.(p.25)

Perhaps this claim for indemnity or contribution should be made subject to mandatory arbitration in order to reduce transactional costs. The primary claim would not involve recovery for pain and suffering and the collateral source rule could be abolished as to such claims as well.

Another item of recovery that could be eliminated is the allowance for future inflation. The courts are divided on whether this is a proper item of recovery. But the better rule requires its elimination because of its highly speculative nature. Also recovery of punitive damages should probably be eliminated. This item is purely retributive; it is speculative; it provides a windfall to the plaintiff, and it has no place in a compensatory tort system. If the defendant's conduct is sufficiently reprehensible, criminal rather than civil sanction should be the appropriate remedy.(p.26)

Many defendants complain today about the fact that products liability claims may be asserted long after the goods are transferred by the defendant into the stream of commerce, after memory has lapsed, records have been lost or destroyed and the state of the art is significantly improved. The latter may nevertheless be used retroactively by the plaintiff as evidence of what should have been done either originally or subsequently.

It may seem wise, therefore, to provide an outer time limit after the transfer of the goods or the furnishing of services within which a products liability claim must be asserted. Ten years may be an appropriate time for this purpose. If a person uses an automobile or a piece of equipment or a household appliance that is ten years old or older he should be on notice that the product may no longer be safe to use, although he may have a claim against its immediate seller if that sale occurred within a ten-yer period. Exceptions may be made for situations such as fraudulent concealment and promises expressly extended to future performance.

It is arguable that Federal or state regulatory standards should preempt the common law. It seems doubtful, however, because regulatory standards can be minimal and do not usually keep abreast of changing expectations. The clear trend has been that compliance with the legislative or administrative regulations is some evidence of reasonable conduct but is not conclusive on the issue. It seems better to leave this accrued development in the law as it is.(p.27)

One other proposal I might comment on in connection with damages is a dollar limitation on the amount of recoverable damages for example in connection with pain and suffering.

Personally, I believe that such a proposal would be much more clearly subject to constitutional attack than any other type of limitation might be. Indeed, the Illinois Supreme Court very recently has struck down a dollar limitation on the amount of pain and suffering in connection with medical malpractice claims as being arbitrary and capricious. So it seems to me that that would not be a feasible way to pursue the problem.

CHAIRMAN SCHWARTZ: Thank you very much, Professor Phillips.

We are going to switch now to the economic perspective that the Task Force and working Task Force members have discussed; and our first speaker is well qualified to give us that perspective.

He is Professor Douglas Olson, of the Wharton School of the University of Pennsylvania. The problems we are facing in the products liability area are not totally new to him. His Ph.D. dissertation was on insolvencies among high risk automobile insurance companies. He has also published a monograph for the Department of Transportation entitled "Price and Availability of Auto Insurance in the Non-Standard Market."(p.28)

He has also worked on a research, or is currently involved in research on business attitudes towards risk management insurance and related social issues. All of these are relevant factors for our study today.

Professor Olson.

MR. OLSON: What I am going to do today is speak from the point of view of the mechanism that is supposed to fund the injuries that are sustained by virtue of product failure, the failure of a product to behave in a safe fashion.

My interest started in this about a year ago when a colleague of mine and I designed a survey which was administered to 1200 business executives, lasting an hour and a half in length. It was a personal interview survey, and among the issues that were examined in that survey was the question of product safety, or the safety of services.

What we found in that survey was somewhat disturbing to us. We found that there was a surprising lack of consistency among businesses today in the regard that they hold for the problem of product safety. Even businesses which seemed to be doing precisely the same things, putting out precisely the same product, have a totally different viewpoint of knowledge existing among businesses today regarding the extent of public concern with product safety.(p.29)

We also found that the industries which tend to pay the greatest attention to the issue were not the industries that we expected. Medical health services were high. That was clearly expected, because of the malpractice crisis. But the other industries that were especially concerned with the problem were industries such as transportation, warehousing, and public utilities. Industries such as food processing or beverage processing, consumer goods with which the law has built a great deal of its rationale for the last 50 years are way down the list as far as the concern of the manufacturer.

It has also manifested itself in the fact that there is a wide difference of opinion among businesses with regard to the kinds of safety or loss prevention efforts that they should be making. Again, the businesses which seemed to be engaged in putting out virtually the same products or producing virtually the same service have a totally different attitude toward the notion of quality control. This has serious implications for the insurance industry; and so it is from the insurance industry's point of view that I would like to start attacking this issue.

I think that if you talk to people in the insurance industry, the kind of impression that you will get is that they feel that they are suffering from a thing which I characterize "a crisis of uncertainty." It is simple uncertainty. And the reason for that is that the technique which they typically rely upon to predict the cost that they will be insuring in the future is breaking down.(p.30)

The actuarial technique does not work well under conditions which are similar to those which have existed in malpractice and in products liability more recently.

Essentially, the actuarial technique looks at claims experiences which have been incurred in previous years, adjusts those claims for changes which they believe are taking place, searches for trends to determine in which direction those claims are going; whether they are becoming more frequent, or whether they are becoming more severe; searches for outside indicators to help determine in which direction the claim is going, and then pitches those costs into the future.

It is upon that pitch that the premium has been based.

If the situation becomes, from the point of view of the actuary, erratic, so the trends seem to be moving up and down, or there seems to be random fluctuations in cost which are virtually unexplainable, then from the point of view of the insurance company there are very serious questions. And one of those questions, and the one that most underwriters seem to be asking in products liability today, goes something like the following:(p.31)

Can I legitimately risk the assets that sit behind the rest of the obligations that I have in all the other lines of insurance to back a relatively small area which heretofore has been relatively small called products liability. To what extent can I legitimately risk those assets?

Unfortunately, the answer is coming out these days that the situation is highly erratic and that people are beginning to be less willing to risk the resources to back it hence; we find pockets of unavailability.

We also find quick increases in price. Now that has a relatively serious connotation. What it will generally imply is that there will be movements towards self insurance. So what we are noticing today in the insurance industry is that there are a substantial number of businesses which have decided to, in the medical malpractice lingo, "go bare." They are now going bare. Small businesses which heretofore would have never dreamed of self-insuring the products liability situation have simply decided to assume the risk on their own.(p.32)

Now, in a sense, self-insurance, captive insurance companies, or all the alternatives to the private insurance mechanism, are desirable. They are desirable because such a procedure generally serves to focus the attention of management on the fundamental issue: preventing the loss from arising. That, after all, is the principal concern, it seems to me, of the whole products safety area, preventing the loss.

But in a sense it is an extremely dangerous movement. Manufacturers for the most part who are moving in this direction are not at the present time equipped to allocate financial assets to back the potential liability. They simply aren't in a position to do so.

We have heard statements from manufacturers that say, I cannot afford the premium; I am simply going to self-insure this problem; and if the claims become too big, I am just going to go out of business. Well, going out of business is going to strand the victim.

In the area of Worker's Compensation, or occupational disability, we require businesses, as a condition of being able to engage in business, to prove that they are financially able to fund the claims which result from the disability of their own employees to prove that they are financially able to fund the claims which result from the disability of their own employees.(p.33)

Is it any less justifiable to place the same requirement on businesses today with regard to the injuries which are sustained because of unsafe products? What is the reason for differentiating between these two areas? At the present time, there seems to be no such requirement. Businesses can "go bare."

For all intents and purposes, it is pretty easy to determine exactly what areas are going to be particularly difficult insurance problems.

Assume that you are an insurance company for a minute, an underwriter for an insurance company, and a manufacturer is now approaching you requesting product liability insurance.(p.34)

That manufacturer has been in business for several years, and he may have a substantial backlog of products outstanding, a backlog of products for which there are virtually no records, absolutely no records. You don't know how many of those products are outstanding at the present time and, even worse, you hardly ever know what the safety requirements were that were used at the time the product was produced. You don't know anything about quality control; you don't know anything about the testing; you don't know anything about the criteria that you really want to know in order to be able to assess your liability.

The promise that you'll have to offer that manufacturer is a promise which agrees to hold him free from the financial responsibility of having to face any injury that arises during the policy period. It is not just covering the products that you are putting out today. It is any arising from any product distributed, no matter how long ago that product was put out.

Where is the problem coming? The problem is coming in durable goods manufacturing. Underwriters and insurance companies today say the vast majority of the product liability problem is in durable goods manufacturing, because of the uncertainty that is involved. Durable goods by definition are those goods which stand up for long periods of time and about now which we know very little.

From the point of view of the manufacturer, the price that you quote it, is going to be extremely high relative to his current sales. Because the obligation is not linked to total sales. The obligation is linked to the production activities that have existed for many years in the past.

Yes, it is quite possible that products liability premiums today will be 25 to 50 percent of sales, of current sales. So the motivation for self-insurance is obvious.(p.35)

If you wanted to talk about the real focus of attention today, then according to underwriters in insurance companies, that focus is industrial equipment.

Supposedly, the scenario goes something like the following:

An employee is injured. His injury is attributable in some way to his use or proximity to a particular product, an industrial machine. He is particularly unhappy about the reparation that he is able to -- I am sorry -- the compensation that he is able to receive under the worker's compensation system, and so he searches for viable alternatives, something that would help to make up the difference between his actual losses and the losses that the workers' compensation has been willing to provide him.

In that search, an obvious target is the manufacturer of the industrial equipment, and so he brings suit against the manufacturer. Clearly, if he can find assistance in this area, there are clearly numerous people who are ready to assist him in prosecuting the claim.

I ask you to consider the following: Is it going to really reduce that tendency by merely lifting the workers' compensation benefits? One of the proposals seems to be to increase the workers' compensation benefits; to preclude the employee from suing the manufacturer of the industrial equipment; and to preclude subrogation between either the employer and the workers' compensation carrier and the manufacturer or his products liability.

Clearly, I could not be more in favor of the first point. We have had a lot of problems with workers' compensation and a system for stimulating adequate attention to occupational disability. It doesn't do an adequate job, we believe, today, because the benefits aren't high enough. Benefits translate into premium costs. If benefits are low, the costs that are imposed upon the employer are going to be low. The benefits are simply inadequate. And I am somewhat in favor of the notion of precluding suit between the employer and the manufacturer of the industrial equipment. There is certainly sufficient precedent for going to a kind of no-fault system for occupational disability. But why not simply rectify the inequities that exist in that system.(p.36)

I am not, however, in favor of relieving the manufacturer totally of responsibility. The only way I can see to retain stimulus for the manufacturers to produce a relatively safe product is to provide for some sort of arbitration, binding arbitration arrangement between the employer or his workers' compensation carrier and the manufacturer or his product liability insurance carrier.

What about the "tail"? Everybody who has talked about malpractice has talked about a thing called the "tail". Is there a big "tail" in products liability similar to the malpractice "tail"? No, there doesn't seem to be. Because the promise that is offered by a products liability insurance company is not the same as the promise that is provided under malpractice insurance policy.

A malpractice insruance policy promises to provide the health-care provider with protection for any injuries that arise out of any procedure which is performed during the period in which the policy is in existence. That is not the same as the promise provided a manufacturer under products liability. The products liability promise only covers injuries that arise during the course of the policy. Therefore, relatively straightforward changes in the promise under the malpractice insurance policy which hold a lot of promise for coming to grips with the products liability problem. "Claims-made" policies will help. But they are not the real issue.(p.37)

The real issue sits in the backlog. It is the backlog of products, which you virtually know nothing about.

I think I will let my comments rest there so everyone can react.

CHAIRMAN SCHWARTZ: Thank you very much.

Our next speaker is an economic expert, nationally known, who is Chairman of the Department of Economics of the University of Rochester; he has served as a consultant for the Rand Corporation and also, which is directly in point here, as a consultant to the National Commission on State Workmen's Compensation Laws.

Professor Walter Oi of the University of Rochester.(p.38)

MR. OI: With respect to the welfare of consumers as a whole, the larger social issue that Mr. Phillips was talking about earlier this morning, we want policies that are going to minimize the sum of accident cost and accident avoidance cost, and add into that which Calabresi has called the tertiary administrative cost.

Now, in the area of product safety, a number of people argued that we want to design a system that will have at least two desirable features; first, that the levels of risk that the society ends up incurring in equilibrium is in some sense optimum in the sense that all parties are exercising due care.

The second is that if we as a society are risk-averse and the older we get the more we intend to be that way, we want indemnification for random losses; we want compensation; we want to fully insure, if we can buy that insurance, at actuarily fair odds. A variety of factors, reasons, have been advanced on why the private insurance markets will not achieve the optimumness of risk, a compensation for damages when they occur.(p.39)

These reasons include, one, that individuals systematicallly underestimate the risk. Tuversky and Khanneman have provided ample evidence that individuals faced with complex situations have a great deal of difficulty in developing unbiased, objective estimates of risk.

The second reason that is advanced contradicts the doctrine of consumer sovereignty; that is, we must impose compulsion, because some people will never insure and they do not know what is in their own self-interest; and therefore we must impose on them systems of health insurance, retirement insurance, disability insurance; because in retrospect they will feel happier having had it.(p.40)

A third reason is the question of the free rider; that is, some people will not insure because they feel that if they happen to incur the injury, a benevolent society will somehow take care of them.

Two other reasons are advanced: namely, the cost of administering insurance and the difficulty of achieving sufficient subcategorization.

And finally there is the most important reason -- what I have always called the moral hazard -- namely, the very fact of insurance changes the odds and the magnitude of the losses.

And I think here we come into a very difficult issue. Economist have not done a good job in determining what are the right valuations in undertaking risks. Is it the present value of discounted earnings? And the answer is clearly no. That is a wrong measure. It may serve as an approximate measure.

What is the value of a disability? We don't know that. Furthermore, I don't know of anyone who has done a comprehensive study of what accounts for court settlement for various injuries; how much of it is attributable to the region that you are in, the type of attorney you had, the contingency system, so forth and so on.(p.41)

Another question that needs answering is whether or not the courts and the judicial system are in the best position to determine these losses in trying to determine what is an optimal level of risk to build into a product. Ex poste evaluations are very different from ex ante evaluations. And the courts are always looking at it after the event and looking at the particular circumstances of the particular injured individual.(p.42)

Finally, regarding the factors that cause industrial accidents, there are certain random inherent risks that are unavoidable, and the very system of negligence and assignment of fault necessarily minimizes the importance of a random, unavoidable risk. And as far as I can tell, the principal factor that accounts for injury, and the reason why work injury tends to go up with the business cycle and to go down with the business cycle is largely trying to get the workers in the work place to know one another. Labor turnover is perhaps the biggest fatal factor accounting for the cyclical movement in injury rate, and also the attitude toward risk-bearing. It is true that the frequency with which a person will get injured declines monotonically with age, at least with respect to males.

However, the frequency of serious injury monotonically increases with age.

Why?(p.43)

Young people will take risks. But the probability of them being seriously injured, their youth, their nimbleness, and so forth, somehow prevent them from becoming seriously injured.

Furthermore, we don't know how much of that serious injury, the movement into permanent-partial disability, at ages of 50 and above, is simply a substitute for retirement. These considerations I think are important in determining what ought to be the right valuations that we are using, whether or not we ought to assign liability to the manufacturer, what liability we assign, and whether it should be judicially determined or determined by some limited schedule as workmen's compensation initially was intended to do.

CHAIRMAN SCHWARTZ: Thank you, Professor Oi.(p.44)

The next speaker's name has almost come to mean or be a synonym for approaches towards no-fault compensation systems. He is a professor of law at the University of Illinois; his book that he co-authored, "Basic Protection for the Traffic Victim," was instrumental in creating changes, major changes, in the method by which victims of auto accidents are compensated.

He has specifically directed himself to the problem of products liability in a book that was funded by a number of organizations, including the Guggeinheim Foundation, that addresses itself to the products liability problem.

Recently he has written articles that directly touch our concern with third-party claims.

Professor Jeffrey O'Connell of the University of Illinois.

MR. O'CONNELL: Thank you, Victor.

Let me start out with a couple of premises: first, we probably are wasting our time here this morning; secondly, we are probably wasting our time working on this report. The report, if I judge it correctly -- and I have been a part of many of these dreary groups -- the report is going to come in with a very strange mix of recommendations that won't make any difference if they are enacted and nobody will pay any attention to your report anyway. And I think we might as well relax and accept that.

Let me tell you why I think in a way that's a tragedy: because I think I understand, as I listen to these very excellent speeches, that somehow, as a very curious thing in the 20th Century, we are continually reinventing, or not even trying very intelligently, to reinvent a wheel.(p.45)

Aside from the premise that the tort system is an absolute scandal; that it was wildly a scandal at the turn of the century, and proceed as such -- and that every intelligent social reformer at the turn of the century said, We have got to get rid of this thing -- as far as it affects the main group of people who are being injured in our society -- namely, industrial accident victims.

Workers compensation was seen to be sine qua non of an intelligent, functioning industrial society. Very early, in 1877 or so in Germany, 100 years ago in Germany, they saw the need to scrap the tort system and go to essentially a simplified insurety then. And then the British saw it, and finally, with an absolutely primitive view of social conditions and social insurance which has always prevailed in the United States, even the little United States saw it in 1907.(p.46)

Over the next -- well, it took 35, 40 years -- that we finally enacted workmen's compensation in every jurisdiction. Would you believe, in the United States, the final workmen's compensation statute was enacted in 1940? That was Mississippi, which told us something; but -- which was a backward state, of course.

By 1920, every sophisticated state in the United States had workmen's compensation. They had scrapped the tort system as it applies to personal injury and had instituted a reasonably simplified insurance. They said it is absolutely wild after every accident to be asking whether the worker should have seen that oil slip, whether he should have moved his hand a millisecond faster or a millisecond slower, and whether the employer should have moved something a few feet further or a few feet slower.

Scrap this damn thing and say when people are injured in the course of employment, pay it. Now, don't pay them under this roulette system that the lawyers have figured out. I mean compensation for all their loss, despite the fact that you have already been paid from somewhere else. Don't pay them for all their pain and suffering, because no one knows what that is anyway. Pay them subsistence, to keep them from being destitute after that. And let them go out and buy all the insurance they can. But pay them middle-class, blue-collar wage loss and pay them all their medical. And we did that in every state of the United States by 1940.

It didn't work. It didn't work very well. But compared to the tort system, it was wonderful.(p.47)

Now, the workmen's compensation had a lot of problems in this country. No one would deny it, except when you compare it with tort liability. Then it is the most wonderous thing ever done. And no state in this United States, once it has enacted workmen's compensation, has ever seriously thought about going back to the tort system, which will be so stoutly defended by my fellow lawyers here. No state has ever even thought about it seriously; wouldn't think about it seriously. And the report of the National Commission on Workmen's Compensation said, with all its inadequacies, no one would conceivably resuscitate the tort liability system as it applies to industrial accidents.

Okay. We did all this. But would you believe it, we stopped and we left the tort system intact for all other forms of accidents. Absolutely crazy. After the institution of workmen's compensation, we started to have auto accidents at a pace which dwarfed even industrial accidents. And what did we do about it? We kept arguing endlessly, after every auto accident, whether the guy was doing 35 miles an hour instead of 30 miles an hour and did the pedestrian look both ways, and we spent all the money arguing these trivial matters, rather than pay people money when they got hurt, which I had assumed was the purpose of insurance -- not to pay us lawyers to argue whether somebody was going 40 miles an hour instead of 41 miles an hour, or 35 miles an hour.(p.48)

We never learned that for a generation, two generations, three generations; finally, in 1960, somebody said, "Jesus, this is a crazy system we have got here. All the money is going to insurance companies and lawyers. Can't we do something about it?" Well, there have been studies for years showing how this system was a disaster, starting in the 1930's. Academic studies by persons with impeccable credentials. But no, the United States under Mr. Walsh here insisted on taking two years and spending $3 million to study it further. And then they came out with figures that were almost to the decimal point what studies had shown him ten years before.

Now, they did a great job. It was a great study. And, finally, slowly, trudgingly, states started to enact no-fault laws, and they are working.(p.49)

Let me give you some figures from Michigan to show what you can do with the tort liability system when you scrap it.

In Michigan, prior to no-fault auto insurance, they had a requirement of $20,000 tort liability insurance. Everybody had to have that. It wasn't compulsory, but in effect it was compulsory. Very few people ever got paid that $20,000 you understand because, of course, it was usually alleged the the accident victim was contributorily negligent . So we could discount all those.

But at least that was there as a possibility. So then they have no-fault enacted in 1973. These are the benefits they provide: at a lesser premium for personal injury than used to be charged for $20,000 tort liability, they provide unlimited medical for everybody; I mean, a 27-year-old person who is a quadraplegic, who is never going to work again, who is going to need round-the-clock nursing care for how many years, and our medical profession, for all its inadequacies, has turned out to be a genius at keeping us all alive when we shouldn't be.(p.50)

They are on the line for every dollar from first to last, unlimited. Plus $36,000 in wage loss. $1,000 a month for three years, tied to inflation so it is now $1200 a month; plus $20,000 residual tort liability because they kept the tort claims for anybody who suffered substantial bodily impairment, whatever the hell that means. But at least it wiped out enough of the smaller tort claims so that you got those kinds of benefits.

That's the tort system versus the no-fault system.

Now, what's that got to do with you?

First, you ought to say, "Isn't there some way we can get some of that over on what we are working on? Is there any way we can do it?" And the answer is, maybe no, maybe not. It is a different problem. John Wade put it very succinctly. Automobile no-fault insurance is first-party insurance, that is, you are paid by your insurance company; products liability, on the other hand, is so-called third party insurance, where somebody else pays you. But note that workmen's compensation is third-party insurance; workmen's comp is third party. The employer is liable in tort for the employee and we wipe that out and we have a plan on a no-fault basis.(p.51)

So that distinction doesn't hold up. No-fault traditionally has been first-party as well as third-party. So don't let that frighten you.

Now, John raised another good point. Obviously, it is very hard to say everybody injured by any product by any injury arising out of the use of a product, let's say, is going to be paid automatically for all his loss. We can say that with reference to employment, and that's the criterion for workmen's comp, injury arising out of the course of employment, pay him. No questions asked. Don't tell me he was careless; don't tell me you were careful. Pay him!

Automobile accidents arising out of the course of the maintenance and use of an automobile, fine. Most automobile accidents happen, people were fine before the crash, now he's got a broken arm, pay him -- or a broken head.(p.52)

(Inaudible). I grant you, the "match case" is a good example, the "stove case" is a good example. But for everybody who burns his hand on a stove, regardless of fault; the stove manufacturer is going to pay everybody who burns his hand on a stove? That would be a pretty big burden. Claim frequency would probably go up very high.

Stairs, anybody falls down stairs, paid by what? The carpenter who put the stairs in? The person that build the house? The lumber company? (Inaudible). So you can't do it across the board.

But it isn't impossible to get a handle on a lot of it.

Keep in mind that what happened with workmen's comp and what happened with no-fault, and with all the problems -- and we could sit here for three weeks and discuss all the problems -- they work a hell of a lot better than the tort system. And you must never forget that.(p.53)

What those two systems did, they said, forget about fault, forget about pain and suffering, use the money you used to spend on lawyers, on pain and suffering, and in the case of no-fault auto, paying people all over again when they were paid from Blue Cross, and pay everybody, regardless of fault, on a limited basis, maybe $200 a week wage loss maximum, maybe all medical, and nothing for pain and suffering. That's the trade. We can't do it across the board for products, but I am suggesting we do this: you could pass a law -- it could be a Federal law; it could be a state law -- let me warn you of one thing. If you suggest it be a Federal law, you have automatically escalated the discussion now into two bitter fights, (a) tort liability versus no-fault -- and there is a lot of fighting about that that we shall hear -- and (b) state versus Federal. And a lot of people who are for you and get convinced by the figures that I am using and that you gather, are going to say, great idea, but I'm a States Rights man. Go an tell the legislature of Kentucky to do that. And that is a perfectly valid point in the Federal system. So I warn you, suggest a Federal law, but keep in mind that now you have doubled the fight.

It doesn't make any difference who passes the law, though. You could pass a law in any jurisdiction level, state or Federal, which allows anyone who is in a position to agree to pay for injuries arising out of the use of his product, on a no-fault basis, whereby he gets a tort exemption. In other words, if I manufacture a power tool, I say, anybody who loses a limb through my power tool, I will automatically pay for a prosthetic device; I will automatically pay for rehabilitation training; I will automatically pay for psychiatric bills, which very often happens as a result of depression; I will pay what workmen's compensation will pay in terms of benefits. I will pay everything.

Or I may put a limit, up to $20,000. Anyway, I will pay, automatically, on a no-fault basis if you use my product and are injured in these defined ways. By the way -- if you were my employee and you got hurt the same way, I would pay automatically. And I will pay you $200 a week wage loss. And I don't care how careless you were using it; and I don't care if you were drunk, just as I would pay my drunken employee, just as no-fault insurance pays the drunken driver. Now, we can discuss whether you want to include drunks, but if we are going to have an insurance mechanism, drunks are probably going to be a substantial part of the people that get hurt.(p.54)

In life insurance we pay them; we pay them health insurance. Well, in sum, let's really have it no-fault. Let's not say, but people who vote Republican, or, you know, do some terrible thing, cannot qualify for this. Make it no-fault the way workmen's comp is no-fault, the way no-fault auto is no fault; really no-fault, I don't care how careless you were. You were using my product, and I will pay you, in exchange for which you can't sue me in court.

I have got some figures which I published which I will give to you which indicate that less than 40 cents of the insurance dollar ever gets to an accident victim, and about only 14 cents pays for losses not already covered, out-of-pocket losses not already paid from some other source, 14 cents out of a whole dollar to pay for what insurance ought to pay; and very few people get it, and when they get it, it is two and four years late; then they end up paying one of us lawyers a very substantial amount of whatever they win over that law fight.

So I am saying, let anybody who wants to, who thinks he can beat this frightful system we lawyers have created, do so. Let the market function; because what the legislatures and workmen's comp and no-fault auto have decided is a better system; it is going to be applied across the board; but anybody who thinks he can apply it with reference to his product ought to be allowed to do so.(p.55)

And think what this would mean in the capital goods area. The manufacturer could say, I will pay for anybody injured using my product who loses a finger, loses a hand, loses an eye; I will pay automatically beyond workmen's comp. I am not going to duplicate workmen's comp. But if there are frightful cases where workmen's comp is not adequate -- and very often it is not; we know that; very often the benefits are inadequate -- I'll pay more; I make up for it and pay the medical expenses that are not covered; I will pay for wage losses that are not covered under workmen's comp. And very often, as we know, workmen's comp wage loss is never adequate.

And so we need the insurance dollars not to duplicate all the money or to trade money back and forth between insurance companies, but use these casualty insurance dollars to supplement and pay in the tragic cases when workmen's comp or health insurance or other schemes are not paying enough.

And I suggest to you with all due respect that, unless you go to the issue of the compensable event, and start eliminating tort liabilities, with litigating on the negligence, and litigating over the value of pain and suffering, everything you do is not going to make that much difference.(p.56)

You can change the statute of limitations, although we have had a very eloquent statement about how bothersome that is, because there is no quid pro quo there; you just take away rights; don't give any in return. You can have arbitration and all you do is add another layer of proceedings; you have got to pay arbitrators now. That's a grand waste of time.(p.57)

That's not the issue. The issue is how hard it is to decide whether the product is defective and what is the value of pain and suffering. So all these other suggestions that are made, one gets a terrible sixth sense of vision -- it's all through the art of 5 per cent. Let the arbitrator arbitrate these claims; let's have an assigned claims plan. None of it made any difference; none of it ever could make any difference as long as you litigate these very cumbersome events. And what I am saying to you is that is the only hope of improving it; maybe it won't make any difference.

But I assure you, if you look at the workmen's compensation experience and if you look at auto, it is the only thing that has ever worked.(p.58)

Let me mention another device. Maybe you can't pass a statute. Because if you are going to apply this, my scheme to capital goods people who don't have a privity contract relationship with the workers, you will probably need a statute. I have also suggested in some writing that I have done as far as consumer products are concerned, maybe you ought to be able to do this without a statute at all. Just do it by contract; put it in the warranty. And of course we would have a lot of trouble with that. I have written a defense of it from a legal point of view; I think the court ought to sustain it, by contract, put it in the warranty when I sell you a power tool, I agree to pay, regardless of fault when you lose your limb. And I bind you by that contract. Well, it's a novel legal scheme, but rather than wait for legislation -- and I have spent the best part of my life waiting for legislation in no-fault auto -- let me offer a solution for the capital goods manufacturer.

Without legislation I would allow unions and management and manufacturers of capital goods to get together and bargain and say, Why don't we contract between the three of us not to have our employees, when they are injured, using your goods, never sue you in tort, in return for which we will lower the price which you are now paying for tort liability insurance and we will take those savings, and we will increase the benefits payable under workmen's compensation, when workmen's compensation isn't sufficient, which in most jurisdictions, it isn't. Or we will even increase the health-insurance benefits, or we will increase pay. I don't know what the hell we'll do with the money.(p.59)

Anything. Let's burn it.

Let's get together and contract to use that money that is now being largely spent on insurance overhead and legal fees, and we will use that to pay our people more benefits. And we will bargain about it, whenever the money is available; and we will have an extra pool of money to divide in a time of economic recession. That doesn't call for any legislation.(p.60)

It would take big parties with major premiums, they could divide up. But I would suggest, with all the money at stake, with all the harshness at stake, and with all the delay and bitterness functioning in this system.

But you see the color of the present system is that it combines the two worst things you can have; it combines waste and want. Now, think about that. Either one of those things is very bad. We all agree waste is bad; we watch our kids waste things, as we know, it doesn't matter whether they waste them; what the hell is the difference whether they drink the glass of milk, the potatoes in the restaurant. We hate to see those potatoes not eaten and wasted. We don't like waste.

But waste is not so bad if it is not something somebody might want. And this system seems to be inextricably married to those things. We spend all of this money litigating these essentially trivial matter while people go unpaid for desperate losses.

Now, I have spoken in a colorful vein, and I have spoken to my own profession with humor. Let me say that I am a lawyer -- and I am very proud to be a lawyer -- I wouldn't give up all the riches of being a lawyer, not even for all the benefits of being a highly paid civil servant --

(Laughter)(p.61)

MR. O'CONNELL: But I think we as lawyers have immersed ourselves in a situation where we are not productive. On a case-by-case basis, we do help our clients, we do help people individually get paid. But since the turn of the century, when any objective observer has come in to look at the tort system, be it government official, be it foundation, be it journalist, be it a government study of the dimensions done by Dick Walsh, anybody who looks at it says it is a disaster, a disaster. And we lawyers have refused to recognize that. And it is a disaster. And you are to take it as a disaster and look for ways to change that compensable event and make it more manageable; and if you don't, you will have wasted your time and, more importantly, my time.

Thank you.

CHAIRMAN SCHWARTZ: Thank you.

The next speaker is Dick Markus, who is a noted Cleveland attorney and also a law professor. He has written more in the law reviews than probably the average law professor, who is supposed to be spending almost his full time at such a task.(p.62)

He is a former President of the American Trial Lawyers Association; for those of you who just may not know, that is an organization that has generally been associated with the plaintiff's side of the aisle; he was a member of the National Commission on Medical Malpractice and is currently a member of the AMA Commission on medical Professional Liability.

Dick Markus.

MR. MARKUS: Thank you.(p.63)

Generally, I would like to begin by drawing a distinction between this field and the medical professional Liability field, to which there have been other references. There are some significant differences and some reasons why the problem is approachable in a completely different fashion in one area than in another.

First, it is important, socially, that physicians be able to practice. They are providing an essential service. It is critical to the rest of society that physicians be available; and if there is something that is severely disruptive of physicians' services, something has to be done to solve that to assist the rest of society. It is not critical that widget manufacturers be available. In fact, if widget manufacturers are not economically able to justify their existence, it is better that widget manufacturers go out of business and be supplanted by somebody else who provides a somewhat different product or a somewhat different service. So that that element of the critical service is less real in a products field than it is in the medical field.(p.64)

Second, in the medical field, the substantial changes in premiums that occur in a relatively short interval create a greater economic problem than substantial changes of premium in the products field. This is because suppliers of products are able to change their prices momentarily. If they choose to have a new price that they will attach to their product, they simply announce the next morning we have a new price. And if their premiums increase in such a fashion that they feel they must have a new price, they do it. Physicians and hospitals cannot do that; because the overwhelming majority of payments to physicians and hospitals are not from their patients; they are from third-party carriers, government and private third party carriers; and those government and third-party carriers do not permit them to make

sudden changes in prices. Instead, there is a time lag of somewhere between eight and 18 months, between the change in cost factors and the change in their ability to recoup those cost factors from such third-party carriers. That makes the severe problem to them in the short run, which might in the long run be able to be taken care of, but which is sufficiently severe in the short run so that there is no good answer for them.(p.65)

Now, having tried to clear up some of those distinctions, let me give you what little thoughts I can on the issue that you are facing here, what may be a problem to some and what may be a crisis to others.

There are -- I see four different kinds of proposals that have been presented in the discussions here, and they have also been presented in the papers that we had a chance to review in advance. They are, first, methods of reducing the frequency and severity of losses; second, methods of changing the loss distribution; third, methods of changing the dispute adjudication mechanism; and fourth, changes in the insurance mechanism.

Personally, I believe that the first of these proposals, that is, to reduce the frequency and severity of losses, is the only long-term, rational method of alleviating the problem. It may not be a short-term solution at all; but in the long term, the only justifiable method of facing the issue is in some means to reduce the frequency and severity of losses.(p.66)

Some of the proposals that are in the literature we have had occasion to look at, include inspection or regulation of manufacturers or sellers or users, -- and I include in "users" employers and consumers, or anybody. Another method of reducing the frequency and severity of losses is in fact this horrendous tort system that has been described by Mr. O'Connell. That horrendous system does in fact impose severe economic sanctions on the person who has a non-economic product, in the sense that his product is causing great damage and he cannot buy insurance and is forced out of the market. He simply is unable to compete. And if he has a total disinterest in safety, a total disregard for such considerations, basic first-year economics teaches that he will not be able to compete and he will cease to exist; because that becomes part of the cost of the product.

A third form of reducing the frequency and severity of losses is the developing of greater knowledge and data to give greater guidance in how one goes about identifying particularly onerous risk situations and minimizing those risks. All of that is our first category of reducing frequency and severity of losses; and I commend that to anybody who wants a long-term solution in this field.

The second area is changing the loss distribution.(p.67)

This area is somewhat illusory. One gets the impression that we are making huge strides when, in fact, what we are doing is simply saying a different fellow should carry the burden. There are, for example, the proposal that greater portions of the burden be put upon the injured victim. He should be less able to obtain payment for whatever damage or loss he has sustained. And at least we have the illusion then that the cost of the total system has gone down. Of course, the cost hasn't changed one whit. We simply said that somebody else will bear that cost.

One method of doing that is to say that there is a limit on the amount of payment he can receive totally, or limit on what I call "general damages."

Those who are accustomed to opposing general damages typically use the euphemism "pain and suffering," because that is harder to understand and harder to define; and it is easy to say that nobody should be paid for those things. So that we keep in perspective what that means; that is the loss of an arm or blindness, or the inability to move your leg. That is pain and suffering. It includes disability, disfigurement and all of the disasters of human losses which are so real to a person who suffers. It may not be real to anybody else. But to the person who suffers them, they are disasterous losses.(p.68)

Now, one can limit the amount of payment to someone for human losses in which case you are saying you absorb the human losses rather than having someone else provide compensation or payment for them, you absorb that loss. You can similarly impose greater restrictions on statutes of limitation or on the ability to assert third-party claims under certain circumstances, all of which are saying that the victim should absorb a larger part of the losses; and that is a method someone can justify, or others can criticize.

Another person to whom you could shift the loss or make have a greater part of the loss is the employer in the employer-employee situation. Increase workmen's compensation benefits, and the employer then has the burden or must attempt to shift that burden to an insurance mechanism in which he pays higher premiums.

You can say that he would be responsible and that if he takes on the vendor or the supplier's responsibility, this is done through both legal and contractual relationships. What I referred to in the literature that we saw are vendors endorsements or such arrangements in which the liability is being transferred contractually from the supplier to the employer-user.(p.69)

There was a suggestion in some of the literature to establish a federal cause of action related to OSHA violations, a cause of action against the employer. Again this is shifting some of the burden to the employer instead of to the employee. And then you could have more of the burden -- and this is a third possibility -- on the supplier, the manufacturer, have a bigger burden on him, instead of a smaller burden.

What was described as a non-fault mechanism -- and if I may I would like to here describe that -- would in my judgment impose a substantially greater burden on the manufacturer supplier. Not only do we have the problems that were suggested by Dean Wade and others, that if we say that all injuries related to automobiles are compensable product liability injuries with regard to the legal fault, or without regard to culpable conduct in any way, which would impose a fantastic shift of the cost to the automobile manufacturering industry from all the others.(p.70)

But if we say no, we are not going to do that, but as my colleague Jeff suggests, we instead have a selective system, in which just those people who want to, will guarantee to pay for certain reduced losses, but not all of them, regardless of any moral, legal or ethical culpability, I submit to you this would mean a geat increase in the cost of those suppliers. It has been my experience that the people who would be interested in such a concept would be the people in the area where there is a higher-risk product. He suggested chain saws or punch presses, things of this sort.

Yet, those manufacturers are able to avoid liability in an immense number of claims now, whereas under the situation he described, they would be faced with such liabilities and unless the liability that they would be faced with would be one one-twentieth or one one-hundredth of the magnitude of the liability that they are now faced with, they would face an increased cost. In other words, the frequency would be immensely greater and the total cost would be much greater.

The suggestion by those who feel that that is an outlet, I think, assumes that we can do that by having an immense reduction in the severity factor, by not paying a great number of things, and hoping that means that those losses just went away. But of course, all that is doing is going back to our first premise, that we shift some of the losses back to the victim, make him absorb more of the losses. And those are questions that people can rationally discuss.(p.71)

Then of course, the fourth person to whom you can shift is the public. And I mean by that in the general sense there can be public subsidies to any of the above entities, to employees or consumers, in the form of publicly-funded health insurance, wage continuation insurance; that is a method of shifting costs which may or may not be a good method.

Or you can have a public funding of employers or manufacturers through subsidies of their insurance or their re-insurance. Those are methods in which the public will take a larger part of the loss distribution.

Third category. The first was reducing frequency and severity of losses; second is changing the loss distribution. The third is changing the dispute-adjudication mechanism.

As to this, I tend to agree with my colleague, Mr. O'Connell, that that is not really part of the so-called crisis, if there is a crisis, or even part of the problem, if there is a problem. There is some advantage to using an arbitration technique in some situations, socially. There is some advantage in my judgment to using a full jury trial technique in some situations. I am not sure that I would be happy in having all first-degree murder cases adjudicated by arbitration. I think that might bother me. And I am not sure that I would be anxious to have all wrongful death cases adjudicated by arbitration. That might bother me also. There are some matters that are sufficiently important that we would be willing to use what is unquestionably a cumbersome, expensive and time-consuming mechanism because of its seriousness and complexity.(p.72)

There are some subjects which are relatively less complicated and relatively less serious in which we say a rougher form of adjudication may be more suitable. And I think that there could be a sensible balance as between these two. Whether these things are binding or non-binding, there are some pretty good arguments both ways. Frankly, I usually find that if you have a non-binding adjudication mechanism, all you are saying is that you are going to have two adjudications, a non-binding one and then a binding one, and that just doubles the administrative cost and usually is not very helpful.

There is a discussion of comparative negligence in the literature that we reviewed, and of course that is another method of changing the dispute-adjudication mechanism and may or may not have merit; but I am not sure that it has much special merit to this particular field.(p.73)

As to the installment payments, my brief comment is this. Certainly the best method would be to have an adjudication every year, forever, to have a new adjudication. And better if we did it every month forever. But that is too cumbersome and too time consuming and too expensive; therefore we don't do that. So we are forced by that consideration to involve ourselves in some degree of future speculation.

The use of installment payments does not remove that speculation; because we still have to speculate about the future as to: first, will the problem be greater or less in the future; will the disability be greater or less in the future; will the reimbursement that one obtains on earnings, the recoupment on investments, will that be greater or less in the future; and these are difficult speculations that will occur no matter which system you use in fact may be worse under an installment-payment system than under a lump-sum payment system.(p.74)

The fourth category of proposals that I saw in our material was a change in the insurance mechanism.

I would echo the comments made by Professor Olson, that there are two different kinds of problems as to insurance. One is an availability problem; that is, the fact that insurers may in fact not be willing to write in the field, regardless of what the premium is. That is also true in the medical professional liability field and for the very reasons that he explained.

As to the question of availability, that is one thing that can be faced, and there are some suggestions that have been made relating to assigned risk programs, greater use of reciprocal, public insurers, either Federally or state-funded, and others, all of which are worthy of consideration.(p.75)

The last part of insurance is the question of the cost of the insurance, as to whether there is an increase in the cost or not, and to what extent it will be increased, and I suggest to you that that is not as severe a problem as people are making it, and I come back to where I started, and that is why I wanted to end there.

Increased cost are a reflection of the increased economic cost of that item. If we believe in internalization as a insurance concept, then it is best that the cost of a product reflect the cost of the damage that it causes; so that this can be compared in the economic market with other products, either of the same type or different types; and so that the consumer can determine which is better for him to purchase, considering the total cost, including those resulting costs.

CHAIRMAN SCHWARTZ: Thank you, Dick.

We are privileged to hear an equally prestigious member of the defense bar, the President of the Defense Research Institute. That Institute is helpful to lawyers on both sides of the aisle and academics, as well in producing substantial literature on a number of tort problems throughout each year.

Mr. Wallace is a member of the International Association of Insurance Counsel and the Federation of Insurance Counsel. He is also a Fellow in the American College of Trial Lawyers.(p.76)

Mr. William Wallace.

MR. WALLACE: Thank you, Mr. Chairman.

[Mr. Wallace briefly described the objectives and organization of the Defense Research Institute.](p.77)

I have decided to change my remarks and to talk to you simply about some of the problems that I see on a daily basis, problems that are brought to me by manufacturers, their concerns, and share those with you, and then maybe if there is a little bit of time left, talk about what the Defense Research Institute is trying to accomplish with respect to product liability and how hopefully we can be helpful to you all.

First of all, I guess the problem started, as you might imagine, having even the non-lawyers in the group, with the extension of the doctrine of Section 402(a), the strict liability, product liability doctrine. We have learned to live with that for the most part, that is, defense lawyers and manufacturers around the country; and we have adjusted to that newer concept; but some of the problems that we are experiencing today are the elimination of some of the traditional defenses that we have had over the years. We have had, as you know, elimination of contributory negligence in many, if not most, jurisdictions. We have had serious limitations of the so-called state-of-the-art defense in many jurisdictions. We have been very concerned about the submission evidence of post-accident design or manufacturing improvements. We have been concerned by the imposition of what we call the collateral source rule, which has been talked about here before, and which, in effect, seals the lips of the defendant who can't point out to anybody that perhaps the hapless victim of this accident really isn't quite so hapless; that he has received workmen's compensation benefits or has received retirement benefits or has had his medical bills paid through other sources.(p.79)

We have also seen the rise of the doctrine of what was referred to as foreseeable misuse, the series of crashworthiness cases, and other applications of that same doctrine, all of which have occurred in the last five, six or seven years; we have seen the attempted elimination of the concept, in strict liability, of what we refer to as the "unreasonably dangerous test." This is a recent development, occurring in some of the more "progressive" jurisdictions such as California and perhaps in Pennsylvania, which is of great concern.(p.80)

We have seen the rise and the increase of the awarding of punitive damages against manufacturers.

These are the kinds of legal concepts which have been worrying manufacturers; the other concept that worries them is the general application of strict liability to the so-called design case. In reality, it is believed by some defense lawyers that that type of litigation is better tried in the confines of a design negligence case.(p.81)

Now, here are the things that I hear from the manufacturers:(p.82)

They seem to be most concerned about the extended life of many of the products that we are called upon to defend; that is, the equipment which was manufactured 20, 30 years ago, which causes an accident, is called to task and it is our job to defend. It becomes a more difficult job. Documents are gone. Witnesses are gone, as are individuals who would have been available at an earlier date. Manufacturers and defense lawyers say this is difficult to cope with.

There is a reluctance on the part of many courts in our judgment to closely scrutinize the qualifications of some so-called expert witnesses. And you see a variety of these people who come to court; many of them are very talented individuals who have a high purpose and are schooled in the particular area that they are testifying in, and then there is the group who travel the country who testify one day on one subject and the next day on the other. The courts permit this kind of an activity; and it may well be that the witness knows nothing, or little or nothing, about this product or this type of engineering. But because he is an engineer, he is permitted to testify in great detail and to redesign this product in front of the jury.

Now, manufacturers also tell me that they are concerned about the lack of protection afforded by reason of adhering to industry standards. It is sort of the damned if you don't argument, but you are not necessarily saved if you do.(p.83)

There is also a feeling that industry products are being measured by current thinking, current engineering standards, and that these standards exceed any level that were available to those manufacturers a number of years ago when they were in fact trying to put these things together.

We believe, too, that the best defense to a products liability case is not to have an accident. And one of the ways that we have attempted to assist in that is through an educational program. We have talked with manufacturers around the country, both in meetings and also through our publication, indicating that what we would hope that what they would do is develop better quality control. We have tried to tell them in our humble judgments how that can be done; how to come up with design review committees; how those committees should be constituted. So there is an educational effort going on at this time.(p.84)

Now, I believe that there is a product liability problem. It may have crisis proportions. But I guess I am not prepared to say that we should be junking our system as we know it now.

There are problems with the system; some of them I just indicated to you; but, you know, it is kind of like the patient going in and telling a doctor he has a headache and the first suggestion is, well, let's cut off your head because that will eliminate the problem. I am a little concerned that if we are to abandon something that we have lived with for several hundreds of years, because -- and I know this is unlikely, -- what if those who espouse another doctrine are wrong. It leaves us in a rather peculiar position to try to go back and to regroup.

I am not going to comment on all of the proposals that you have in your staff work, because DRI itself is working on a product liability position paper. You might say it was kind of a duplication of effort, but maybe that's not all bad. And this is what we have done so far.

[Mr. Wallace described briefly the process of developing DRI's position paper.](p.85)

Some of the things that we are thinking about, just as you are thinking about, are the concept of binding arbitration, or arbitration generally, and will this work. I am not sure myself. We have had some -- Dick may agree or disagree with me -- we have had some success with arbitration of a non-binding variety in the courts in Cleveland for smaller matters. I certainly would agree that in the large case, the loss of the arm, or what have you, you may be introducing multiple levels of adjudication by having a non-binding situation. On the other hand, there are a lot of small product liability claims, too, which in and of themselves are not distressing to industry, but when you put them together collectively they mean a lot of dollars, either dollars out of pocket or premium dollars.(p.86)

How's the time?

CHAIRMAN SCHWARTZ: Close or else.

MR. WALLACE: He says "Close or else." I don't know what that means.

(Laughter.)

MR. WALLACE: In each of these areas, there are a number of suggestions. We will make the paper available to you, and I hope that you can make some use of it.

I appreciate the opportunity of being with you today.

Thank you.

CHAIRMAN SCHWARTZ: Thank you very much.

Our next speaker in a sense is a guest and in a sense is one of our own. She works for the government as a senior economist on the Council on Wage and Price Stability, a co-author, with Roger Noel on a monograph on product safety for the Brookings Institute; but she is not a member of our task force, and in that sense she is a guest, and that explains her appearance here this morning rather than this afternoon.(p.87)

Dr. Nina Cornell.

DR. CORNELL: Thank you.

Judging from what has been said and what was sent to me in advance of the session, the biggest emphasis on product liabilities seems to be the machine used in further manufacturing processes. I gather that there have been some references to what I would call consumer product safety and consumer product liability questions.

But the big problem seems to be the case where the product being insured is a machine to be used and a worker gets injured, leaving aside for the moment exactly how the machine contributes to it.(p.88)

If indeed there is a problem that jury awards are rising -- the amount for a given accident is now much higher and not explainable just by pure inflation of the economy as a whole, but some special inflation applying to jury awards in the field of product liability.

If indeed this has happened, or many more awards are being made today for cases that would not have ended up with a victory for the plaintiff in the past, one can look for two possible causes. One, that's been alluded to several times in this panel, is that the workmen's compensation system is no longer working adequately and that I think is a very probable situation. The workmen's compensation system has been well described, I think, by Mr. O'Connell in terms of what it was intended to do in the first place. It was intended to get away from the tort system, with its having to prove fault and saying to the workers as a class -- that we will find a substitute for an occasional and somewhat random throw of the dice in which some people are big winners and most of you are big losers because you get nothing. Under the substitute everybody will get something, but it will be capped, we will put a limit to it.(p.89)

From an equitable sense, you can say that the same pool of money was spread over the class of people likely to be affected in a probably more even way. One can make a great claim for equity for that.

The employers, on the other hand, receive two factors; in one sense they may have gotten pretty much the same incentives that they had before, to try to run a safe work place, in that the total amount they might end up having to pay out for damages was maybe greater, I don't know the facts as to what actually occurred under, before and after the introduction of workmen's compensation.

It was a more even system, in which the incentive to try to achieve what I agree with Dr. Oi is the optimal; that is, the minimization of costs of accident prevention plus the cost of accident avoidance, plus the administrative cost. It is a more certain incentive, that each work place bases on their workmen's compensation type of system. He knows what his premium is; he can look around the factory and decide where he can go in and try to weather the likelihood of accident and where that cost of change is less than the amount of premium he is going to save, he has gained. I think I have got that one straight.(p.90)

And every place that he can save money by making accident-prevention moves that thereby lower his premium by more than the cost of making the change, an employer has an incentive to do just that.

What has happened is, I suspect that study would show, is that the caps on workmen's compensation have not kept pace with inflation and has not kept pace with changes in wage levels. And accident victims feel more and more squeezed by what they get, versus what the promise of assistance seems to hold out.

There may, however, be a second factor at work, if indeed jury awards have changed in the manner that I suggested in the beginning. And that is that as a society we seem to be moving to say that risks we used to accept as a society as being an individual responsibility, we are no longer willing to see as an individual responsibility. We seem to be demanding that these risks be covered, in the case of employee accidents, as part of the cost of doing business. And I would suggest that this may be true of that random set of elements that again Dr. Oi referred to earlier, about whereas before, as a society we viewed it as appropriate for workers to bear those random elements of risk, we may be moving away from that.(p.91)

That would indicate that indeed even changing workmen's compensation to make it what it was before, plus an inflation in wage rate change adjustment, would not be adequate, that you would still have the pressure of people feeling that workmen's compensation awards, now adjusted, don't meet what it is they feel workmen's compensation ought to be providing in some sense of ethical, moral judgments, or political judgments. And they would then be again turning around to see where they could get the money they feel they are due out of the system and that place is the manufacturer.

I question the statement made earlier that nobody else has questioned, and maybe I am wrong, that workmen's compensation is a queer way to put an incentive on a products manufacturer for a safe product. I view it as a very efficient way to put the proper incentive.(p.92)

If you try to attack the compensable event -- and I also agree with Mr. O'Connell that that's where the focus ought to be; what is it that causes this -- the compensable event, the injury that causes people to turn in the first place to the liability system.

If you are looking for a way to structure a response to the compensable event, in a way that puts the incentive to minimize the sum of those three costs that have been talked about one before, it strikes me that improving the workmen's compensation system -- with some room for going back to the manufacturer for truly defective equipment, where the defect is directly the outcome of the manufacturer of the equipment and not the outcome of failure to maintain or failure to install correctly, or the fact that it was a truck that crashed on its way from the factory to the original recipient or to a second recipient or the third recipient -- is the way to go.(p.93)

Workmen's compensation gets at all of these if the system is done right. The problem gets to be if you limit the award of workmen's compensation you have not put the full incentive, to completely internalize the cost, onto the cost of doing business.

On the other hand, if you don't limit the workmen's compensation system, you are back with the product liability case only now you have it in workmen's compensation.(p.94)

It is interesting that in discussing -- when Mr. Markus discussed the medical malpractice insurance, I would argue that the two reasons that he said it is not comparable to the products liability system, I find myself grossly disagreeing with it. I thought they were -- I don't somehow think that doctors are vastly more critical to the workings of our economy than machine-tool manufacturers, even though widgets per se may not be very valuable. I don't know; I have never seen a widget.(p.95)

Machine tools, however, do have a great input into our economic well being.

I also think it's false to say that manufacturers' prices can change faster than those in the medical profession. Those of us who have experienced having our insurance pay the doctor and then getting a residual in our own private bill, that residual can change very fast.

I would argue that one case where it is very different from the problems in machine tools, where technology has changed, but the uncertainty principle underlying technology has not changed nearly as rapidly as in the medical profession. I think the medical malpractice liability situation is undergoing a dramatic change because we have learned so rapidly so many causes of illness and disability that we did not know two, three, five, ten, let alone 20 years ago.(p.96)

That makes it a very difficult time for any kind of actuarial experience or any kind of experience to come along and tell you what the cost into the future is going to be. I can see that I am about to get a time warning. Hopefully, there will be time to make other comments --

CHAIRMAN SCHWARTZ: There will be. Thank you very much. There will be more time this afternoon.(p.97)

It is sometimes bad to be last in one of these panels, but people get tired and hungry, so I ask you to abate your hunger temporarily, rejuvenate temporarily, because we are going to hear a perspective that is probably going to be different than any we have heard thus far, where the importance of the professional engineering and what they can tell us and what they can do in this area is highlighted.

Professor Alvin Weinstein has written, in conjunction with others, some main pillar interdisciplinary pieces along these lines. He is a professor of mechanical engineering and public affairs at Carnegie-Mellon University.

Professor Weinstein.

MR. WEINSTEIN: If you're looking for a definition of "unreasonably dangerous," it's the last speaker before lunch when you're running late.

(Laughter.)

MR. WEINSTEIN: And I thought, up until just about an hour ago, that I was a flaming liberal. But after hearing Professor O'Connell, I am an introverted conservative.

(Laughter.)

MR WEINSTEIN: The product liability problem exists; there is no question that it is with us; but I am not in favor of the solutions that seem to distort the basic system. I think what we really need is a system of fine tuning. Yeah, there are problems that exist from top to bottom, but I am not certain there are any measures where we can completely eliminate the problem. But I think that what we are really talking about is focussing on what the meaning of "unreasonable danger" is.(p.98)

I am assuming, as a premise, that strict liability will be with us for a long time, and I am sure that the legal college takes heart in that.

"Unreasonable danger" says to me that we are as a society, whether we be manufacturers, insured, or consumers, they have to live with reasonable danger. I think that is what is being clouded; that we haven't yet uncovered the distinction between reasonable danger and reasonable safety.

Miss Cornell suggested that maybe we are leaning too far on one side, that we are unwilling to accept risk. I think that is true, but maybe it is because we as consumers aren't really aware of what the cost is ultimately, in asking for the increased safety.

I don't know how much mandated safety ought to be in every product in the marketplace; I don't know that. But I think that there does exist a level in which both the manufacturer, including the manufacturer, the insurer, labor, consumers, all have a stake in trying to seek this balance between reasonable danger and reasonable safety. You all know the problems, the problem of communication; the fact that the manufacturers tend to view the safety as a tack-on consideration and not part of the design and design-use process, a reluctance by the insurance company to look at liability minimization rather than loss prevention. The reluctance of the consumer to really indicate where he is willing to take risks.(p.99)

What I am suggesting is that where we have to work is that in each of these areas, manufacturer, consumer, labor, insurers, have to work more diligently in uncovering this distinction between reasonable danger and reasonable safety.

What does that mean? It means that groups such as OSHA and CPSC, who are trying very hard to come to grips with this, ought to be more responsive to the private sector and the voluntary and consensus organizations; the voluntary and consensus organizations on the other hand ought to look realistically at injury patterns, hazard patterns, and develop standards that are more responsive to this distinction.(p.100)

CPSC and OSHA aren't going to be able to legislate or mandate standards for every product on the marketplace; we are going to have to depend on this private and voluntary sector.

I think you need some kind of mechanism which permits an interchange between the public and private sectors regarding basic problems that exist and the use of voluntary standards.(p.101)

What I am suggesting of course is not significant changes, but there has to be a system of incentives as well as disincentives.(p.102)

For example, suppose, in the best of all possible worlds, that we begin to develop standards, product safety standards that have a reasonable balance between safety and risk. I think a lot of the incentives to the manufacturer who finds these standards and uses them, not a disincentive not to use them but an incentive to use them in the way we litigate possibly injury arising from a product that has met these standards.

Let's perhaps increase the burden, right? Unless they eliminate it completely, because I don't think we are really always capable of deciding that precise line between a reasonable danger and a reasonable safety; but I am saying once we have made a legitimate decision on a product standard that becomes promulgated, then let's make an incentive to use that by making it more difficult to litigate as a result of injuries, once it has been demonstrated that the product is in fact meeting the standard.

What about insurers of homes? Do they have a responsibility to make an inspection as part of the three-year renewal, to come around and take a look at the home?

What responsibility do they have to diseminate material from NBS or whatever Federal agency that indicates how to treat products in the home as part of their ongoing -- this in the long run helps them; it can reduce flames, reduce fires, reduce hazards. (p.103)

What about the resellers of products? When a manufacturer diligently comes up with a retrofit, somebody ought to know about it. It shouldn't necessarily be the decision of the user of the product to decide whether or not to use the retrofit; if the retrofit is important to reducing the risk of injury, it ought to be put on, and if not, there should be a disincentive not to, that his comp rates go up and he is subject to litigation by the employee directly.

There are many little things and maybe some that are not so little that I think can affect the substance without affecting the whole element. That there are -- I think the problem can be minimized or at least reach the appropriate level for living with it by fine tuning and not for excessive, significant changes where the government tries to underwrite, or tries to bypass the basic problem by taking costs where they should be delivered to another part of the system.

I think I will quit there.

CHAIRMAN SCHWARTZ: Thank you.

(Whereupon, at 12:15 p.m., the meeting was recessed, to reconvene at 1:30 p.m. this same day.)(p104)

CHAIRMAN SCHWARTZ: I think we can begin our afternoon session.

We are going to have an opportunity for each of our speakers to make whatever comments they wish to make on other speakers' presentations; and an opportunity for questions from any one of you about any of the presentations.

But first, members of the working Task Force are going to make a rather brief presentation now.(p.105)

CHAIRMAN SCHWARTZ: Dick Walsh has had experience with a massive study by the DOT, following some of the same problems that we face today, and I think we would be interested in hearing briefly some of the parallels that you see and do not see.

MR. WALSH: Listening to the discussion this morning, I harken back not to my own experience in the auto insurance study that DOT did, to another study that was -- produced one of the finest government reports I ever read. It was done up in New York State, and the title of that report was "For Whose Benefit?" I think it is a very germane question in this that we ought to keep before us when we talk about the products liability system.

That report posed, in a rather kind way, I think, the question as to whether the system exists to compensate victims; does it exist to provide some kind of internalization function so that society benefits from the workings of the marketplace in trading off the cost of injuries or cost avoidance; does it work to the benefit of manufacturers, in order to protect them against unfair, capricious legal acts by people whom they don't even know? Does it exist to allow the insurance system to get capital for our economy? Does it exist in order that a finely-tuned legal system can sort out the many rights and wrongs that exist in the kinds of transaction that give rise to product liability?(p.110)

I think that if we think about it very long that we can come down on the side of an answer that says predominantly the system ought to exist to compensate victims. And once we have made that decision, I think that a lot of the other things that we talk about kind of fall into the proper perspective.

I was struck today by the similarities between the way in which this study that the Department of Commerce did arise and the way in which the Federal attention to automobile insurance arose.

The first thing that happened when I walked on the scene in automobile insurance was that somebody told me we had an availability problem; and the whole problem was getting insurance to people who couldn't ordinarily get it, the old, the young, and the unemployed and the people in our society whom the tort system and the insurance system does not look favorably upon.(p.111)

And on the whole that's exactly what's happened here. We have small businesses who can't get insurance until all of a sudden there is threat to the workings of our economy. It seems to me that as we plough through the thicket of claims and counterclaims that maybe we are able to identify in the auto insurance medium that the very reason why insurance is not available to these particular classes of people was due to the capricious workings of the automobile insurance tort liability system. And it was the tort liability part of that system that turned out to be the thing that should be corrected, and not the creation of some kind of insurance mechanism that artificially pushed security in the direction of these disfavored people.

I have already gone on further than I wanted to go on. Thank you very much.(p.112)

CHAIRMAN SCHWARTZ: Thank you.

Eli Bernzweig was the Director, Project Director of the HEW Secretary's Commission on Medical Malpractice and has had to some extent may have deja vu feelings, as Dick Walsh must have, and he will I hope speak to us again at greater length about the parallels between the two studies. But today he at least wants to highlight that.(p.115)

Eli?

MR. BERNZWEIG: You're right; it is a case of deja vu as far as I am concerned, if for no other reason than it's the very same Cabinet officer who created that commission who is involved in this one.

(Laughter.)

MR. BERNZWEIG: He's everywhere.

This issue has its genesis, as you've already learned, from external sources and both problems again have this in common and that they have been brought to our attention through the insurance mechanism.(p.116)

Certainly both the malpractice issue and the products liability issue are national issues, for reasons that I have mentioned: more claims, higher awards. But the amazing thing to me about the analogy is that in neither case do we really have any data upon which to predicate intelligent judgment.

We are talking about a problem which very few people can say with any degree of certainty that these are the numbers, there are the premiums, these are the aggregate claim costs, these are the average claim costs. We don't know anything about where claims are truncated; we don't know where -- who's paying more of them; we don't know much about the re-insurance factor; so the dearth of data is just incredible; and yet we are supposed to as a task force come up with some meaningful solutions.(p.117)

The pressures for reform come not from the injury receiver but the injury causer. And this is always a suspicious type of thing and, again, is something that Mr. Walsh probably hinted at. You kind of wonder why the people who are the beneficiaries of products that are either defectively made or negligently manufactured don't organize as a class. Well, it's for a very good reason. Those who do suffer injuries are more adequately represented by private legal counsel, and the broad class of consumers as a whole just don't perceive any threat until such time as the cost of those products gets out of hand, until the cost of medical services gets out of hand or doctors decide to go on strike, or companies close up, or recall their problems. In other words, something has to hit the individual consumer intimately before something dawns on him.(p.118)

I think that we do have a generic problem here and that is what has been referred to in at least one law review article as the miscegenetic union of liability insurance and court doctrine. Can the two survive in that environment? Or should they survive? Are the goals common enough so that changes in tort doctrine will somehow or other permit the other conflicting goals to coexist? We after all do have conflicting goals.

Insurance companies are not in business to pay out claims; they are in the business to not pay out claims, and to maximize their profits. Injured persons, on the other hand, want to get as much as they can for their injuries, and the only way they can do it is to bring lawsuits. Now, how do you put all this together and try to accommodate the various conflicting objectives? Should you, is the point. Should we be thinking in those terms? Or should we be thinking of various other legal and social mechanisms?

I will leave you with that pregnant thought.(p.119)

CHAIRMAN SCHWARTZ: Thank you very much.

We are now going to go through our group of guest speakers briefly in case they have some comments or observations that were inspired by what they have heard here.

There are two points on which some of them have already commented, but if they have any thoughts about them, we would be interested in knowing what those thoughts are.

Of course, there may be a situation where smaller businesses, which are defined in the Federal Code as those grossing less than $2 million a year, are more seriously affected by the products liability "crisis" than larger businesses.

Do any remedies salvage or help that particular situation? Second, any thoughts they have on whether or not reform action should be taken at the Federal or state level. But they don't have to -- you are not forced into that framework at all; but those are two questions that I think would be of concern to the group.

John?

MR. WADE: Well, I think that the first thing that has to be decided is the purpose of this study. Is it to try to meet an immediate "crisis," as it is called? Or is it to try to make a long-term solution?(p.120)

If it is the immediate crisis which you are concerned with here, it is making insurance available, and perhaps to reduce the amount somewhat. We didn't have a good deal of talk about that.

Mr. Olson gave us an excellent impression as to the nature of the problem; but the problem had to do with the uncertainty, to the extent that I am not sure that there is a solution to it immediately.

Something ought to be done about that. I am not in a position to tell you what.

It seems to me at least that this group ought to be thinking about long-term solutions, the matter of trying to adjust fairly between the manufacturers and the consumers the injured parties. And I don't know; I get the impression that the place where the Federal Government and its agencies will do most really is not in regard to the law or the system for approaching it, but is primarily in regard to finding ways of cutting down on the accidents, of making safer the product.(p.121)

There are ways of organizing this in a fashion to determine patterns, to put together the various factors in such a fashion that ideas of safe methods may be transferred, getting information. This, it seems to me, can turn out to be really much more helpful than anything else that can be done within this short time; setting up a system.

And it seems to me that this thing ought not to be in terms of just the immediate approach that the small businesses want help; let's give it to them, no matter what it does to the other people.

Just one other illustration and I won't talk longer.

We have got a plaintiff's attorney and we've got a defendant's attorney here. One suggestion was made that both of them agreed with what I thought was awfully important, and it may just be skipped over entirely.

The suggestion was made that when it comes to minor injuries, we might set up an arbitration arrangement to take care of it, and to provide for compensation. What happens now is that's just left out entirely.(p.122)

The plaintiff's attorney can't undertake that suit, because he can't invest that amount of time on it. And there's nothing that can be done about it. So this is a part of what this group ought to be thinking about.

CHAIRMAN SCHWARTZ: Thank you.

Jerry?

MR. PHILLIPS: Yes.

I think we are all agreed that the first line of attack should be to concentrate on safety, improvement of products; there is no question about that. It makes no sense to provide defenses or indeed other avenues of correction if nothing is being done to get at the root problem, the safety of the product. The liability system as well as government regulation go to that, of course, and the marketplace itself.

On the other hand, having said that, I am not sure that it is inappropriate for us to consider other ways of reducing the cost of the system if this can be done equitably.

Now, it is true that in many of these areas we do not have data when we make proposals. It seems to me that at least in the law field, with which I am familiar, most of the decisions we make are made without adequate data, and they are made in some sort of ultimately hunched theory.(p.123)

For example, rules of evidence, for instance, are frequently grounded upon assumptions about human nature which have never been proven. The law operates that way, and I suppose society does to a large extent also.

In that connection, it seems to me that it is appropriate therefore to consider tinkering, if you will, with some of the liability mechanisms that we have today, such as I mentioned before on pain and suffering.

I don't think we can ever know in advance, at the front end -- what effect the removal of the pain-and-suffering item of damages would have on insurance premiums, what effect it would have upon actuarial calculations. That will depend upon what the insurance companies decided to do in whatever mysterious way they operate, in the same way I think almost in the mysterious way that the stock market operates. We can't predict that. And I think we have to -- or rather this agency will have to make the decision that the things they recommend appear to be socially good and may have the lucky spinoff of solving the insurance problem as well. (p.124)

Now, Dean Wade's suggestion of installment payments I think is an excellent idea. It solves many of the damage problems that I was talking about. Again, however, I agree with Mr. Markus; we may be inviting, if we went that route, we may be inviting more transactional cost than we are getting rid of. In the divorce law, you can come in and readjust alimony or child support if circumstances change. That system works, I suppose. It has been suggested that this be done for insurance payments, disability insurance payments.

If that system could be worked out feasibly, and would not be too expensive, it might just well be one of the most important tinkering things that this Task Force or this country can do.

I might respond to the obvious stereotype that Dean Wade made on the statute of limitations question that I raised. He is exactly right that there is a great deal of inequity in cutting off a claim before it has arisen; and we in the benighted State of Tennessee have been through a very painful period in connection with the statute of limitations law for personal injuries. It's just that sort of problem.(p.125)

But all of these questions do involve tradeoffs. It seems to me that if you have a sufficiently long period of time of cutoff, whether it be ten years, 15 years, I don't know, you have ultimately balanced fairly the desire for repose against the need for asserted claims.

This is not an unheard of thing. The doctors, in fact are getting laws passed for a reasonable cutoff period. I think the doctors' period in Tennessee is four years, which is probably unnecessarily short.

Architects and builders across the nation have succeeded in getting local statutes enacted with an ultimate cutoff period at some point in time. I think those statutes can be five to six years. So it is not as if there were no precedent for this; and it is not as if it is necessarily inequitable provided you don't make the period too short.

If I might just briefly address myself to the question of state versus Federal enactment, I personally feel that something of this nature, the problem, if it is turned over to the states for enactment on a recommendation, it simply will not be done. It may never be possible to be done on the Federal level, but the likelihood of getting anything done, I think, is much greater on the Federal level than on the state level.(p.126)

There will undoubtedly be a special kind of suggested large states rights concern involved here, but I think they have to be faced if there is any good to come out of such a proposal. This problem must be faced frontally.

That's all I have to say at this time.

CHAIRMAN SCHWARTZ: Dr. Oi.

DR. OI: I agree with Markus that the long-range solution is with respect to the frequency and severity of the lawsuits. And the right frequency and severity of the distribution of accident losses should depend on the criteria articulated by Professor Calabresi, being the de minimis basis of accident costs and accident avoidance costs.

There are several remarks I want to make on this.

First, the true social cost for the losses for product-related injuries is not the same as a jury-awarded loss. That is I think a fairly important consideration.

Professor O'Connell emphasized this point by pointing out that only 14 cents out of every dollar -- we can argue whatever that number is -- goes to the victim.(p.127)

Number two, that the size of the jury-awarded losses in itself influences the observed frequency and severity of losses.

Now, my contention is that if the size of jury awards rises in relation to the true social cost of the loss, the amount of care exercised by workers and employers will diminish; consequently, the frequency of injuries will rise and the problem will then come that manufacturers will then be forced to adopt higher degrees of built-in safety at perhaps inordinately high cost.(p.128)

CHAIRMAN SCHWARTZ: Thank you.

Professor Olson?

MR. OLSON: I have nothing really more to say.

CHAIRMAN SCHWARTZ: There have been, as some of the members of the Task Force know, many, many commentaries on Professor O'Connell's theories; but since I have been here there have been two points that I have heard from some of the trade association groups and from others; and I will just put those forward so we have some answer from him rather than some third party about these things.(p.129)

First, the manufacturers are concerned that no-fault may cause a lot of new claims that they didn't have before, no matter how they phrase the election, that more minor claims will now come to them that they didn't have to worry about before. And it may end up, the system may end up costing them more money.

On the other hand, those who represent consumers are concerned that elective no-fault places too much power in the hands of the defendants, since they can elect to place certain risks under no-fault and it would be assumed that they place risks where there was or is a high exposure level, leaving other risks, with low-exposure levels, to the tort system; also they could make adjustments as to the amount of coverage; and that judgment might be based on pure defense interests.

Finally, again from the consumer side, it is said that no-fault approaches in this area, may, more than in the automobile area, allow defendants to use assets or money that really isn't their's. Some economist used the word "externalized," but maybe we will put it in better language than that; and if you will forgive a slight digression, one of Professor O'Connell's best -- well, he has a lot of jokes; but this was one of the best ones -- an economist at another session, accused him of being "obscure," among other bits of rhetoric; and Mr. O'Connell said he found it intriguing to be called obscure by an economist -- (p.130)

(Laughter.)

CHAIRMAN SCHWARTZ: -- and I have never forgotten that one.

MR. O'CONNELL: Well, you mentioned a two-pronged attack on my proposal; first, the potential defendants say it is too harsh on them, and the potential payees say it is too harsh on them. I find that a comfortable position to be in as a proposer, to find both of them saying the other has an advantage. After all, to the extent that the first criticism is true, the second one is not; and to the extent the second one is true, the first one is not; which means that I am seen in that very comfortable position of surely being more right than my critics, one of whom has to be wrong.

(Laughter.)

MR. O'CONNELL: And I think in a measure that is my answer.

If the thought is that the claim frequency will rise too precipitously under my proposal, surely the consumer will benefit; but I build in protections for the potential defendant; I say in the first place he doesn't have to pay to the extent the collateral sources pay, which means that in the great mass of smaller cases, nothing will be due, given the very substantial wage protection and medical benefits which are available in our society.(p.131)

I also suggest in some writing that I have done that because my proposal is based on contract, no one need undertake it if he really feels that it will be terribly disadvantageous to him; and secondly, even those who would like to try it but are doubtful about it could use what the insurance people call a stop-loss technique. They could commit a given level of premiums, perhaps half, let's say, of the current premiums, which they are presently paying in tort liability, and they will say, we will pay on a no-fault basis for injuries as long as no greater amount than this number of dollars is committed as reserves to pay these claims. When our reserves committed to pay claims go beyond this stop-loss point, we won't pay any more claims.

And it may be that we won't. By the end of the year, we will see that you have got plenty left; you never did begin to reach it.

On the other hand, if at the end of six months one finds the point of the stop-loss technique has been exceeded, one can stop writing these contracts. So that I build in very careful protections.(p.132)

As far as the consumer is concerned, I start from the premise that in the aggregate, the consumer cannot be treated much worse than he is right now. Anything we do to redefine that insured event, when you look at consumers in the aggregate, and how many dollars are going to them, and how long they have to wait, and their small chances of being paid, most anything you can do to redesign this system is better. And I say that in all seriousness.

So that I am not impressed by those who would dredge up one person, out of literally hundreds of thousands who have benefitted by this system, in the product liability end, who have received a munificent sum of money promptly. And indeed it would be an intriguing venture to try to find such a person.

I am not intrigued that, if you could find such a person, he argues against changing the system in the aggregate. I think those who say the consumer is going to be disadvantaged are simply overlooking the horror that is the present system.

As far as unconscionable contracts being written, we already have very many protections against insurance contracts of an unconscionable nature being written. No contract of this nature would probably be written in any jurisdiction which was not approved by state insurance commissioners or on a Federal level by a Federal insurance agent.(p.133)

You can argue that that's too great an impediment to contract, but I have no doubt that the close supervision of insurance contracts, which has existed in this country since Charles Evans Hughes' investigation of the fire insurance scandal in the early part of this century, is going to continue. And we have less need to fear of unconscionable contracts in the area of insurance than in any other area of contracts in this country.

Secondly, even when the insurance mechanism, the regulatory mechanism misses, we have a very close supervision by the courts under the doctrine of unconscionability, which will strike down contracts which have been drafted to exclude payment in cases where it is not being made now and indeed to exclude cases where payment is now being made.

We have more built-in protections in this area than in any other area of contracts in the United States.

As far as the externality part is concerned, I guess I would disagree with everybody here who has said -- and it seems to be part of a litany -- that the big problem is accident avoidance. I don't think that is a big problem for people in this room. I think that is chasing a will o' the wisp.

Those of us who are concerned with the auto accident problem found going in meeting after meeting, for generations, people said, "The secret of auto accidents is to make better drivers. And if we eliminate the auto accident, we have eliminated the auto insurance problem." Not so.(p.134)

In the first place, we are not going to do it. You cannot have complex machinery, functioning at the rate in which it does in the United States, whether automobiles or power tools or punch presses, without an appalling amount of injuries in an industrialized society always.

Solving the problem of what to do about those accidents is something that is not going to be solved in your lifetime or mine. The frightful situation created by OSHA, with everybody who has anything to do with it says is a total mess, -- it may work itself out in a generation or two, but don't bet on it.

Mine safety. How the hell are we going to be able to deal with mine safety? And where are the democratic remedies on mine safety?

The problems of the Consumer Product Safety Commission. The friends of the Consumer Product Safety Commission; Ralph Nader, who had more to do with its being set up than anyone else, draws back and says, "Well, you know, I don't know whether that whole thing was a good idea or not. That thing is a bureaucratic mess."

I have something to do with them; and the more I deal with the Consumer Product Safety Commission, staffed by good people, decent people, hard-working --

CHAIRMAN SCHWARTZ: One of them is here.(p.135)

(Laughter.)

MR. O'CONNELL: All right.

But it has not been by any standard that I know of, by any standard that I know of, a success at this point, nor do many people look very far along the line to see that we are going to get safe consumer products as a result of that.

So for us to say we are going to study product liability insurance and focus on this other safety problem is simply a misdirection of our efforts.

I think another speaker put it best: the best we can do, given the terribly confused state of economics, the most we can see to is that we don't make too wild an error in giving people disincentives.

When you compare the present system, and how little it deters, the two studies that have been done -- one by the Commission for Product Safety, which antedated the Consumer Product Safety Commission by Professor Whitfield? I forget his name -- Whitford, of the University of Wisconsin -- who found he couldn't get any correlation between the present casualty insurance system and any safety achieved.

And Professor Dennenberg did another study for the same commission and couldn't find any correlation either. And when you look at all the studies that were done under the aegis of the National Commission for Workmen's Compensation, all the studies they did to try to find some correlation between workmen's compensation benefits and levels in safety, no correlation.(p.136)

So I suggest that for this commission, this study commission, to focus its attention on lessening the accident rate would be to dissipate your efforts in the end. You will get nowhere.

You have a frightful insured event, defined about as cumbersomely as you can define it; and as Dick Walsh pointed out, they started to study auto insurance, and there were myriad problems; and they finally -- although the literature could have told them that 30 years before -- the problem was the cumbersome tort liability event. That is what you can change and that is what you ought to focus on.

CHAIRMAN SCHWARTZ: Thank you.

Dick Markus, during lunch, someone brought up Dr. Cornell's point to me about the machine tool industry and some of the other industries that we heard from, that they may be important in our society, maybe not quite of the holy robes of doctors, but they employ people and they manufacture products here, obviously, not abroad.

They say that they are willing to bear the appropriate costs of the injuries their products cause but that the web of doctrines that has arisen had some dangerous wood in it that thrust upon them risks that should not bear, risks where hindsight is used at the trial level for machines that may have been built many, many years ago.(p.137)

Are there any -- among your observations, are there doctrines that you see that favor the plaintiff that could possibly be questioned as to whether or not they place an appropriate cost on a defendant, putting you in a bind to argue against yourself, but you can do it. I know. I have heard you.

MR. MARKUS: First, I think there are virtually no doctrines which favor the plaintiff that are not subject to reappraisal. And I think of no doctrines that favor the defendant that are not subject to reappraisal.

The law thrives on the fact that it is supposed to reflect social consciousness. Whether it does it or not, and whether the people in this room think it does or not, that is its function; and as the courts attempt to reflect what they think are social attitudes, they will, I am sure, modify many rules that are favorable to the plaintiff now and many rules that are favorable to the defendant now.

I don't know that it is terribly purposeful to take out any particular one of them and say this is the one or that is the one, except to say that that certainly should be done, regularly.(p.138)

I think however your question leads to one of the earlier questions that you asked before we started our comments, and that was, does this have some effect on small business that is disproportionate; and you implied in your question does it have some effect on domestic business that is disproportionate?

First, I think we have got to recognize that small business has inherently had more difficulty in surviving with any cost adjustment than large business, no matter what the reason is. We all know that new small businesses fail much more rapidly than anything. In fact, it is considered to be a great miracle to find a small business that continues to succeed over a long period of time; because all of the surrounding environment, and particularly the governmental regulatory environment, makes it very difficult for a small business to succeed.

Certainly cost changes -- and I would include in that rent, labor, insurance, and what have you -- are factors which do affect small businesses more frequently than large businesses. I doubt, however, that one could demonstrate with any reliability that the insurance cost change is any more a radical effect than whether there will or will not be a new regulatory form that has to be filed and served and delivered because of other necessary considerations.(p.139)

Regarding domestic and foreign business, I think there is no distinction, realistically, at least, if we are talking about sales in this market; because, of course, foreign manufacturers are subject to the same liability laws for products that they sell in this market as domestic manufacturers in this market, at least in almost all jurisdictions having the so-called long-arm statutes.

So that they are subject to the same liability laws as domestic manufacturers.

MR. O'CONNELL: Just as a matter of information, do you find they have enough assets in this country that you can levy on them, or do you have to go overseas to levy on them, and are laws such that you can levy on them overseas?

MR. MARKUS: It isn't necessary for me to levy on them overseas; they recognize that they want to continue doing business in this country and if they wish to continue to doing business, if nothing else -- first, they have liability insurance to protect them -- but if they didn't, I would be able to levy on their assets in this country in the receivables they have from all of the people that are buying their products, all of their distributors and so forth. And they would in effect be out of business in this country if they were not willing to be subject to the laws of this country.(p.140)

Let me, if I can, turn to two other subjects that I have more definite comment about.

One was the question, I think, correctly raised by Walsh: for whose benefit is the system? And basically I would agree with his conclusion, with some caveats.(p.141)

He says it probably should be for the benefit of the victim. I suspect that the laws may disagree with that.

The caveats are that it shouldn't be to the complete ignoring of all the other considerations. There is some weight that should be given to the deterrent effects, whether anybody here thinks there is or is not. We are hearing from manufacturers that their rates are going up, and they are unhappy and they are worried about it. If they are unhappy enough to scream to you, they may even be unhappy enough to do something to try and reduce their costs. And that might be something towards safety efforts.

I do not have the -- if you will forgive me, somewhat cynical view that Mr. O'Connell has, that it just doesn't make any difference; that there is all this carnage; just don't worry about it; let's kill and maim all the people; as long as we compensate them right, that's just dandy. I can't take that view; it hurts me to even say the sentences.

I think that the first goal is the humane goal, and if we can accomplish that, and if the compensation mechanism assists in that, that should be a factor in the consideration; not the only factor, but a factor.(p.142)

I agree with Mr. Walsh, for example, that in the auto field, people do not drive cars more carefully because they are concerned about their potential liability. They drive cars safely because they don't want to get killed themselves. But that is quite different from the situation here, where we have someone else and not you at risk of getting killed at all. It's your worker or your purchaser that is at risk of getting killed; and I think that is a different consideration than we will see in the auto field.

So I say, for whose benefit? I would say yes, probably more for the victim's benefit than for any of the other consideration factors; and the answer to that would then be if we in fact want to maximize the benefits of the victim, then we should minimize the defenses of the defendants. We should make it much more easy, much more direct; for the claimant to recover; and the easier we make it, the more certain he is of compensation; the less friction cost he has; he doesn't have to hire a lawyer; and we have to make it as simple as possible.

Mr. O'Connell would agree with that, I gather, because he is saying, let's make it essentially an automatic payment system. And all we are saying is if you make it easier for the claimant to recover, you are going to reduce to some extent, the friction or overhead or administration cost, you are also going to perhaps increase the total aggregate cost; and those are things that you have to balance because in satisfying the interest of the victim, you may in fact produce intolerable costs for not only small business but big business; and I think that is a measurable consideration.(p.143)

The last thing that I want to talk about is to say what I did not say when we were hurriedly going through before and which was raised by Dean Wade and which I think we should be talking about and that is, what short term solutions are there?

I am not an insurance man; however, I have spoken to so many that my ears were tired about what their problems are.

If you are in fact concerned about the availability of coverage, there are realistic, practical solutions; if anybody wants to do them, they are not terribly complicated.

First, there was reference to this technique that is called a joint underwriting agency that makes everybody who writes a wide variety of insurance join in the responsibility for writing this particular kind of insurance -- not necessarily actually writing it, but sharing in the underwriting risk. That has some wisdom in certain narrow fields. I have some doubt as to whether it is particularly good in this field. Because you are talking about a much wider area of risk coverage.(p.144)

The medical field, I can see, is much more applicable; so that you get some idea of comparison in this. This is one fact that was not mentioned before. So we do not know precisely -- as Mr. Bernzweig correctly pointed out, we do not know precisely the number of instances. Probably the magnitude of medical professional liability claims concluded in one year, presently is in the category of 18,000 to 20,000 per year, as contrasted with the number of product liability claims, which may well aggregate one million per year.

So that it is an immensely different universe. And one can approach this in a different way from an insurance viewpoint.

One could, however, take the problem of the uncertainty factor, which disturbs insurers, out of the picture substantially. Insurers, we have been told -- I said and others said -- that they are reluctant to write in this field in some areas because they are not sure whether they are going to make a killing or a disaster. And therefore they are not sure whether this is a good field to wander into for fear that they are subjecting too much of their total assets to that risk.

There are ways of protecting that problem. They are probably with a public insurance mechanism. And I don't mean by that the public selling insurance, or the government selling insurance.(p.145)

One can, for example, have, if it is a critical necessity, a public re-insurance program, either state or Federal. Or even simpler, provide that if the underwriting losses in a particular field, exceed some given percentage -- 50 percent, for example, -- that would be a margin of error that they could perhaps live with; that a percentage of that excess, 75 percent of the excess beyond that, would be a credit against state premium taxes. That is nothing more than saying that the public revenues are then subsidizing the error in calculation for purposes of making those underwriting premium efforts.

I don't say that's the right answer; but there are innumerable rather simple techniques that could be used, if people want to use them, to eliminate the extreme uncertainty risks which are causing insurers to be reluctant to write in this area; and they can be accomplished, usually with a public willingness to accept the extreme risks -- not to accept the risks, but to expect the extremity of the risk.

Those would give the short-term solutions of availability, if that is in fact what the goal is.

I conclude with one last comment.

I read in the newspaper that there is a terribly high level of crime in this country. And I thought as I was listening to this discussion that we could have various approaches to that problem.(p.146)

First, we could make it much more difficult to prosecute cases and to arrest people; and that at least, according to the record, would show that there was less crime, because we couldn't convict anybody, or we convict very few. That doesn't seem to me very satisfactory.

Then I said, well, maybe instead of doing that, we could make better prisons and that would somehow reassure us that the mechanism for handling the crime was better and that didn't seem to make me very happy. And of course, the answer is that there fundamentally has to be some technique to try to either discourage crime from occurring by making the penalties sufficiently severe or reducing the characteristics and factors which induce people to go into crime. And there I thought, you know, that's the same subject that we have been talking about here today. Period.

CHAIRMAN SCHWARTZ: Of course, the -- and I have no, as the Task Force knows, fixed view on this thing. The manufacturers say it is not a crime to take a walk down the street and that's what they say is occurring to them.

MR. PHILLIPS: In connection with this reinsurance proposal you mentioned, Mr. Markus, if something of this nature was done, how would you handle the problem of where the claim was in excess of the amount of exposure of the manufacturer or seller so that there would be potential governmental liability for the excess? Would there be an incentive on the part of the manufacturer in that situation to resist the claim?(p.147)

MR. MARKUS: You are referring to a different concept than what I was describing, but also one that I ascribe to. I was talking about protection of the insurers who are concerned about risk; you are talking about protecting of the insured for excess beyond the insurance coverage that he has; and there is a possiblity, of course, of saying that beyond some level of coverage, whether it is -- a catastrophe level, half a million, or something or other, that -- a governmental fund would provide for the payment, and thereby eliminate the risk that the insured has, as you are describing it.

If you do that, you would, I will agree, have no incentive for the insured, the manufacturer, or his insurer, to resist the excess. That would have to come from somebody else. And I presume that the usual person representing the interests of the state is the Attorney General's office or its equivalent; and I assume that they would have to be the one who would be concerned with protecting such a state fund.

CHAIRMAN SCHWARTZ: I want to go to the other figures. Now, you mentioned re-insurance and we have talked about that.

So it has been said that if there ever were either a state or Federal re-insurance fund, and we were ever to recommend that, along with those regulations, we would have to have some controls by the government to see that the manufacturer was producing a safe product and to see that the insurance companies were not insuring unsafe products.(p.148)

Would you agree that those things have to be coupled?

MR. MARKUS: No question. It seems to me that the fellow who pays the bills inevitably, always is going to have some control over the fellow who incurs the bill.

CHAIRMAN SCHWARTZ: William Wallace, if you had a -- I am sure you do -- have clients that are manufacturers, large manufacturers, or -- could you advise them to consider the O'Connell plan, or would you advise them to consider the O'Connell plan, assuming that was an option in the law?

What would be your thoughts on that?

MR. MARKUS: Just a second.

Before Bill goes -- I could ask Jeff one question.

Has any insurer agreed to write the optional insurance that you were talking about? Has any insurer that you have spoken to -- I am sure you have spoken to many in trying to promote the program -- said they are willing to write it?

MR. O'CONNELL: No; but they didn't want to write workers compensation and no-fault auto either. They would be dragged, kicking and screaming, into any change. And dragged they'll be.(p.149)

MR. WALLACE: The question you pose is what I know of Jeff's plan now, and it is only fragmentary now, and I am the first to admit that, and most pleased to learn more about it -- with what I know now, the answer is no, I would not.

I would not at this time, based upon my limited understanding of what Jeff's plan is with regard to product liability. We have critiqued his latest work and, based upon that critique, the answer is I would not advise my client, my hypothetical client.(p.150)

CHAIRMAN SCHWARTZ: Professor Weinstein.

MR. WEINSTEIN: Last again, huh?

CHAIRMAN SCHWARTZ: Well, I was going to reverse it --

(Laughter.)

MR. WEINSTEIN: What do we have coming up, dinner?

(Laughter.)

CHAIRMAN SCHWARTZ: You seem to be a man who wanted to think it through, so I just reversed it.

MR. WEINSTEIN: The myth, of course, is not to recognize that it is the consumer who ultimately bears all the cost, regardless of whether the injury is caused in the work place or the injury that occurs in the home; and all I think you are trying to say, some of us, anyway, is that those total costs, whether they can ever be reduced or not, I don't think is germane. Not that they can't. But I think what we have to recognize is that those costs have to be distributed, or redistributed, in two ways:(p.162)

The first is to minimize the risk of injury where we can; and secondly, to enhance compensation in those situations where we just can't find any technological solution. That's where no-fault falls down. It will address the second in enhancing the computation; it does not do a thing for the first to reduce the incidence of injury. And part of the costs will be in there. And that is why the suggestion has been made that the social cost ought to be recognized by everybody, including the consumer, his tradeoffs, in terms of whether he wants to be compensated for that injury that may occur to him or that he wants to pay a little bit more so that the general overall risk of injury is reduced.

That's one of the difficulties, too, with the statute of limitations. The statute of limitations doesn't recognize that products have different useful lives. To say simply arbitrarily ten years or five years doesn't recognize that manufacturers of ladders essentially imply these things last forever and get concerned when an accident occurs in ten years.

But there has to be a general recognition that if you are going to talk about statute of limitations for parts it ought to be based on useful life, in addition to recognition of maintenance, service. These are factors that have to be addressed.

With regard to small business, even with regard to big business, one of the critical elements that's missing in all of this liability is to distinquish between unifunctional and multi-functional kinds of products and where should the burden best be borne.(p.163)

A piece of steel is essentially a multifunctional piece of equipment; it can be used in many different ways. Where should the burden fall? If that piece of steel is known to be used for surgical implants by the producer of the steel, then maybe he has the burden, along with the user, to insist that they use the right kind of steel; whereas, if it fits some place else, to the distributor, then the burden ought to be shifted someplace else, where one can make the decision as to how the function of this product is to be utilized; and that is in a sense I think a help for small businesses if we recognize and help them distinquish and set up some guidelines distinguishing between unifunctional and multifunctional uses.

I know some of the problems of small businesses. For example, if you want to sell a piece of equipment, a small producer of a machine tool, to a large user, somebody like General Motors, and General Motors says, I don't want to buy that guard on that machine; I don't want to pay the extra $200 for it, and then the small businessman may in fact be ultimately liable. But maybe there ought to be something with regard to hold-harmless.

If it requires that for reasonable safety that guard be on there and the buyer still choses not to, then the burden ought to shift. These are the kinds of things I have been suggesting in terms of trying to focus at the appropriate points in the system, to try to reach some reasonable adjudication of both elements: reducing the risk of injury and enhancing compensation where ultimately it becomes necessary.(p.164)

CHAIRMAN SCHWARTZ: A number of speakers have gone to, for want of a better word, the deterrence issue in no-fault.

Professor O'Connell has written extensively on this that is, whether no-fault systems provide a sufficient deterrent to cause manufacturers to produce safe products.

Now, if you can do it in a couple of minutes, or could you speak to that, because you haven't, and I know you have in your writing.

MR. O'CONNELL: Well, I must say I think that it is manifest that no-fault can serve just as much of a deterrent function as the tort system. I mentioned that it is very hard to find, based on the only two ambitious studies that have been done on products liability that the present products liability system does serve rationally as a deterrent.(p.165)

One of the findings is that most manufacturers don't follow the insurance cases of their competitors who are producing similar products to learn; they don't, according to the only study that's been done by Professor Whitford, that's what Professor Dennenberg's study shows, that most insurance companies don't provide much loss-prevention services to their manufacturing clients; in fact, manufacturers don't feel they get this kind of information from their insurance, who would logically be in the position to supply it if deterrent were an economically viable factor. So that the burden is very heavy on those who say if you switch, you won't get deterrence. They are assuming there is much deterrence in the present system out of an insurance mechanism that isn't.

MR. MARKUS: Jeff, do you think that the deterrent effect is in some way related to the magnitude of the cost? In other words, if it cost two cents for products liability insurance, I suspect that nobody would pay any attention to that as a deterring effect also. If it cost $76,000 I suspect they might look pretty hard at it.

MR. O'CONNELL: They might. But the point is we are talking about your suspicions; and to turn to the workers compensation study, when attempts were made to find a correlation between the size of the workmen's compensation premium and safety efforts or records approach, in a very ambitious study, which we certainly should look at, they could find nothing. And they were talking about very substantial variations in laws on premiums, from state to state, in comparable situations, where the control factors looked good. Nothing. Couldn't find any correlation.(p.166)

That doesn't mean that the tort system doesn't serve any, or the workers compensation system doesn't serve any deterrence. The point is it is very hard to identify the deterrent effect of any liability system. I am not -- and I don't know why the suggestion is made -- I am not for taking away all insurance burdens on manufacturers. My scheme is very carefully designed to see to it that the manufacturer is given the option of using his present product liability insurance premium to pay on a no-fault basis. But his payout will still be related to the number of injuries produced; his payout will still be based on a variation of claim frequency and claim severity; and it seems to me as long as you are sure that there is some internalization, that's the most you can expect; and the economists can't help you refine this very precisely.

They haven't. They haven't even been able to do it in hypothetical models very effectively; and they surely -- no one has been able to do it based on empirical research.

So I return to the point that I made: do not try to structure this thing to achieve safety. Achieving safety with OSHA and the CPSA is going to be generations in coming.(p.167)

We don't know who may already have too much safety by standards of a lot of countries. We certainly have a lot more safety in autos than anybody else in the world; we say we want more. How much more? No one knows. Economists can't tell us; the philosophers can't tell us. That doesn't mean we throw up our hands and do nothing; but what it does mean is we don't stay wedded to this tort system on the grounds that some other system doesn't achieve deterrence. We don't know that it won't. It may very well achieve as much if not more than the tort system.

MR. MARKUS: Why are you wedded to the tort system for the majority of products, then? You have indicated that this should be on a very selective basis.

MR. O'CONNELL: Because if I tried to pass a law that said every product manufacturer pays for all his injuries, I couldn't give him any assurance of cost. Note how sharply pragmatic I have been in saying to manufacturers, you try it; I am not going to dictate to you how many dollars you should spend for insurance; I am not going to dictate how many people you should pay. All I am saying is you now have a body of dollars that you are spending on tort lialbility insurance.

CHAIRMAN SCHWARTZ: People seem eager to ask questions now; so it is a good time to get them.(p.168)

Yes, sir?

MR. SHAUT: Michael Shaut, from the Department of Labor. I have a question for Mr. O'Connell. Considering that the no-fault system might be voluntary, I don't see how, since the brunt of the problem is durable goods -- at least, that is what this Task Force stems from -- I don't see how that could correct that problem in that if you are going to handle this by contract, these are old.

MR. O'CONNELL: Yes. I would agree that you couldn't handle it by contract, and that is why I propose two mechanisms: one by statute, which would allow anybody to make this mode of payment mandatory; and that was the point that Mr. Schwartz protested.

MR. SHAUT: So that you could thereby affect old contracts?(p.169)

MR. O'CONNELL: You could. You could say from now on, I am going to pay for injuries arising from the use of my product; and you could pick; and you could pick the age; you could say products up to five years old, products up to ten years old; you could pick the age yourself; because I am not. I agree with our engineer friend; I can't tell every manufacturer -- I can't pick a date and put it in the statute. So I'll say you pick a date; how old are your products that you are already to pay for on a no-fault basis?

MR. SHAUT: So you would require legislation?

MR. O'CONNELL: My proposal would require legislation. As I say, I would encourage manufacturers who are directly dealing with their products to do it by contract.(p.170)

CHAIRMAN SCHWARTZ: Another question.

MR. PHILLIPS: One thing we have not touched on in terms of cost directly is the cost of experts in products litigation.

I'm told by some attorneys that represent plaintiffs in cases that in complicated cases, as most products cases are, you will end up with out-of-pocket expenses in the neighborhood of $30,000 or so, in a run-of-the-mill case, football helmet case, for example, that type of thing.

These are both medical and design experts, et cetera. They cost in the neighborhood, I suppose, of $1,000, up to have an expert for a case.

Now, this is in connection with what Mr. Wallace was saying about simplifying the proof of the case. Frankly I don't know what the solution to that is. The cases are complicated, and they are extraordinarily expensive in terms of preparation, not to mention attorneys fees.(p.172)

MR. MARKUS: Can I make some comment? Because I am a plaintiff's attorney, or at least sometimes a plaintiff's attorney when I am not doing other things, like coming to meetings.

(Laughter.)

MR. MARKUS: It is correct that the complexity of litigation in this area is greater than the complexity of litigation, let us say, in a routine motor vehicle accident. And it is correct that the expense therefore incurred for consultants and/or expert witnesses is greater. The numbers, as you have stated, I believe, are unrealistic. I would think that typically the expense factor that you are talking about in most of those cases would run somewhere between $200 and $2,000, not $30,000.

There are some extraordinary cases where that might occur but they are very far between, just as there are some extraordinary cases in which there are verdicts of a million dollars, but they are very far between.

I think there are a lot of numbers that float around.

For example, if I may relate back, Jeff, you have repeatedly said 14 cents goes to the victim.

MR. O'CONNELL: No; I didn't say that.

MR. MARKUS: But somebody else said it. And they quote and they quote; and when you go back to try to find out where it started -- (p.173)

MR. O'CONNELL: If you would like to look at it --

MR. MARKUS: I know where it came from. I read your paper that quoted his paper -- if I could trace them back -- and I have trouble trying to get back to the beginning -- I received very respectable data saying that more money is paid for auto victims, to the victims, than for fire insurance victims, which is of course greatly different from the views that you have expressed.

I think there are a lot of numbers that float around in this area which I am not sure, if we trace them back, whether we can find any really solid source other than that there was once a Congressional hearing where somebody testified and everybody then quotes.

CHAIRMAN SCHWARTZ: Well, I think someone else stated the 14 cents amount, and let me clarify that.

This is from an automobile study; it is said that 44 cents goes to the victim; but of that amount, only 14 cents meets needs that have not been compensated through some other system. The difference between the 14 and 44 cent goes to the operation of the collateral source rule. That's the only non-hearsay we have heard today.

(Laughter.)(p.174)

MR. WALLACE: From the defendant's standpoint, one other thing: many defendants utilize their own personnel, their own in-house experts, in the trial of these cases. Now, I am not saying that that does not cost the company; it obviously does. But it does tend to somewhat minimize the out-of-pocket expense; and I would certainly agree with Dick that the figures that someone has given you -- not that they weren't incurred in that case -- but that's not been my experience; that would be very high.

CHAIRMAN SCHWARTZ: There's a question in the back. David Glancy.

MR. GLANCY: Does anyone have an estimate of how many claims there are of products liability in relation to how many court cases?

MR. MARKUS: Can I take a crack at making some comment on that? I do not have any statistical answer but at least I can use some verbiage to try to put it in a category.

First, when you say "claims," I assume you are talking about personal-injury claims; because if you are talking about product liability claims, that is more comprehensive than if you are describing every item that is returned to the department store by a dissatisfied customer.(p.175)

MR. GLANCY: I am talking about the claim that the insurance company pays that does not go to a court case.

MR. MARKUS: Okay.

An insurance claim, or a claim that rises to the dignity of a dispute of some sort, more than simply a return of the product by the acquirer from the supplier.

I would "guestimate" that handling such claims, both as -- and I have done it as both plaintiff's counsel and as defendant's counsel -- that a high proportion, when compared to auto claims, are filed lawsuits; that is, in auto claims, perhaps ten percent of the claims lead to a filed lawsuit nationally; and I think Mr. Walsh could give a more specific answer to that, but that is pretty close to the right category.

In this area, I would "guestimate" that probably 50 percent or something near 50 percent of the claims lead to filed lawsuits. I would "guestimate" that of the filed lawsuits, probably only somewhere between 5 and 10 percent are actually tried to a conclusion. That is a higher number than in auto cases and a much lower number than in medical negligence. It is more litigious in some areas but less litigious in others.

Is that your experience, Bill?(p.176)

MR. WALLACE: The same.

MR. GLANCY: Can I go one step further then? How many of those cases that actually go to court are then appealed?

MR. MARKUS: Well, that's an even smaller fraction. I don't think that that's any different in product cases than in anything else. I would guess it's probably about the same proportion.

MR. GLANCY: What would you guess? 10 to 20 percent?

MR. WALLACE: I don't know. But only in this respect, the serious product cases seem to get appealed. I suppose that's true of serious automobile cases; but at least my experience in the last couple of years has been that almost every product case we have tried has been appealed, either by the other side or by us.

CHAIRMAN SCHWARTZ: The law is developing more; and that's why.

MR. MARKUS: That's another reason. The greater the amount in controversy, no matter what the subject is, the greater the chance that it will be carried on at another stage of litigation if there has not been an agreed settlement.

CHAIRMAN SCHWARTZ: Are there further questions?

MR. LORANG: Rod Lorang, L-o-r-a-n-g, from the Office of Management and Budget. I have two questions for Mr. Olson.(p.177)

Is there something that prevents insurance carriers from writing policies that would insure only the products produced during the period of the policy rather than the injury period of the policy?

MR. OLSON: No.

MR. LORANG: The second question is: You suggest that the problem with insurability is uncertainty at this point.

MR. OLSON: Yes.

MR. LORANG: Mr. Schwartz has been getting at, and other people have been getting at, solutions that tinker with little aspects of the system and change remedies a little bit in this and that.

Would any of that kind of thing affect in any significant way the uncertainty that is controlling rates for businesses in the products liability area now?

MR. OLSON: Well --

MR. LORANG: Would it help?(p.178)

MR. OLSON: Yes. I mean, some of them would. For example, one thing that I am afraid you can almost anticipate underwriters doing in the very near future is starting to incorporate their own kind of statute of limitations in the contract. What they may soon say is something like we will only cover you for claims arising out of products which you have produced in the last two or three years. That is an unfortunate, but almost predictable, possibility. That's not going to help the victim; but from the point of view of the insurance mechanism, that's going to reduce the backlog uncertainty, that's going to reduce the problem of not knowing how many products are outstanding and what conditions those parts were produced under, that kind of thing; in a reaction which will engender certainty.

In spite of Professor O'Connell's claim that no insurance company would rush forward to insure under an elective, no-fault liability system, my own presumption is that as a matter of fact they would be much more willing to insure under that system than they are under the current system.

It is not high frequency of claims that is the problem for insurance; it's the fact that the claims are unpredictable; and what makes the claims unpredictable in this particular area is that you cannot tell what kinds of rules of the game are going to apply to determine who is going to be responsible for making the claim payments.

Under an elective no-fault system, the rules would be simple. It is not size, it is variation in the claims that occur from one period to the next; and today the principal contributor to variations are subtle changes in the definitions of responsibility.(p.179)

MR. O'CONNELL: Well, I must say, I agree with that and argued that way very strongly in the writing that I have done; but I am sure there are a lot of people in resistance to that logic.

MR. MARKUS: Could I explain why there might be resistance?

You commented that they are quite willing to accommodate to large volume as long as they have reliability as to the severity to some extent. But they also need some reliability as to the volume; and I think that the problem would be that they also are very frightened at the volume considerations that may be involved in Mr. O'Connell's presentation.

MR. OLSON: I have no doubt that they would be in the very first periods of enactment that would be a very serious consideration, the question of how you make the transition out of a system which is presumably based on fault, into one that is presumably based on no-fault.

In that transition stage, you might encounter a problem. And in that sort of arrangement then you can investigate all kinds of alternatives, such as temporary backup reinsurance arrangements with any variety.

But once you achieve that state it would be a very short change; it is a very short-lived problem. Then you are into a situation which is much better than the current one.(p.180)

MR. MARKUS: In contrast, in the auto system, the insurers had a pretty good handle, not an absolutely firm handle, but a pretty good handle, on the universe of claims that would occur; because they knew how many automobile collisions at least inferentially there were; and they thought they had some kind of an idea of what the universe would be for a non-fault mechanism.

But I don't think they have any confidence, they have any feel in this area.

MR. OLSON: That's why I say there would be a transitional problem. There would be a transitional problem.

CHAIRMAN SCHWARTZ: There is one thing that does cut the other way, however.

In the automobile field, the basis of liability was negligence. And you are going over to a no-fault or an automatic payment approach. In products liability today, at least as it's treated in most treatises, it is characterized under the heading "Strict Liability."

They are already under -- close to a no-fault system now. They have no idea about all the cuts and injuries that may not be brought to the courthouse. But at least they are closer to no-fault now than they were in automobiles.(p.181)

MR. MARKUS: I am not sure I agree with that comment.

MR. OLSON: I would like to go back and comment on the first question for a second, and that was a simple yes or no answer.

No; there is nothing to preclude them from introducing a policy which only covers products that are produced during the policy period. In the case of durable-goods manufacturers, however, it is not likely that that will help anything; because then you introduce the same exact problem that exists today with respect to professional liability, and that is a long tail.

You are now projecting for claims --

MR. MARKUS: Do we have any idea whether that's real, or whether that supposes? And I ask that genuinely.

MR. OLSON: What?

MR. MARKUS: I have heard that in the medical field, and every piece of data that I have seen suggests that 90 percent of all medical claims are known by the insurer within three years of the medically negligent act, or the claimed act.

Now, the long tail -- I have trouble finding it there, except in literature. People describe it with great excitement.

Do we know that there are not a few instances, but -- now, let's talk about product liability.(p.182)

We know that there are a few instances, and we can have some interesting stories by one fellow or another fellow; but do we know that there are a significant number of claims that involve manufactured products that are more than ten years old?

Don?

MR. JORDAN: There are two issues I think you're bringing up.

One is the incidence of claims from older parts and another is the incidence of claims where the accident has already occurred but the insured does not know about it, which is called the incurred but not reported problem.

In terms of incurred but not reported, probably 90 percent of your claims have taken place within the last couple of years. We don't know to what extent claims are coming from products produced in prior years as opposed to products produced in current years.

MR. MARKUS: The reason I ask the question is that I receive, of course, clients who come to me; and I am very loathe to take a case involving a product that is more than ten years, or indeed, more than five years old, unless I can see some peculiar characteristics.(p.183)

There are some cases which I have handled -- I had a case involving an airplane that was 18 years old and which was a darned good case and the manufacturer knew it was a darned good case; and they were really in trouble.

But by and large the public, which make up juries, are not very anxious to say that products are good forever; and therefore, the claimant's counsel, if he has any sense, recognizes that's a consideration also; there is a useful life, as was suggested, to products, whether it has been put on by manufacturers or put on by juries, which says that things aren't good forever; they wear out.

And I am wondering how many of these things actually occur in litigation that produce payment or whether it is more something that is interesting to talk about and to write and base theories on.

MR. O'CONNELL: If I can interject my impression, for whatever it is worth, based on a study done in Michigan of the long-term problems of medical malpractice, they found that a more severe statute of limitations would make very little difference; because many of these tales were anecdotal; and I would agree with Dick that these are the cases that get everybody excited and they are very hard, as the tale is told; but on my own hunches, changing the statute of limitations would be of marginal help to manufacturers as a group at best.

MR. WALLACE: Excuse me.(p.184)

I guess I disagree with my two colleagues. Again, this is only based upon personal experience. I would say that we are faced on a daily basis -- that's not true -- on a weekly basis, -- with products -- and I won't mention manufacturers -- that have been in the field anywhere from five to 15 years. They are hard goods and these products are producing very substantial injuries.

Your office has one of them, as a matter of fact.

The machine tool industry has had some of that problem, too, where there have been some presses that have been of substantial vintage.

It's been my experience that there are a lot of old products floating around that are producing both claims and lawsuits.

CHAIRMAN SCHWARTZ: Well, this is one of the things that we are trying through our industrial survey, both in-house and through our request-for-proposal contracts, to find out.

John Flannigan, have you to date accumulated enough information to at least make a statement on the matter, John, in terms of numbers of cases?(p.185)

MR. FLANNIGAN: We can't really say, yet.

MR. OLSON: Yes; but I think an essential response to that statement goes something like the following:

While we have very little information, hard data, on this problem right now, depending upon how you define the problem from the point of view of the manufacturer, whether it is high price or unavailability of insurance, the issue is principally an issue of industrial equipment. In fact, most underwriters today in insurance companies would say that if you wipe out industrial equipment, we are ready for anything else. It's industrial equipment that's the problem. And that's the kind of equipment that will give you these long tails, if one can ever exist.

I had an underwriter tell me that they will take virtually any consumer goods that comes to the door. Consumer goods are not the problem. It's this other stuff.(p.186)

MR. MARKUS: If that is the fact, then why would anyone consider a limited statute of limitations for anything except those areas?

MR. OLSON: Which areas?

MR. MARKUS: Well, you said that only long-term, durable machine tools are subject to these long-term claims. This is one of the things I worry about. You start saying that we should have a law that imposes a ten-year statute of limitations from the time of manufacture.

MR. OLSON: I didn't say it.

MR. MARKUS: Well, somebody did.

And they did it on the rationale that it applies in that situation. If it's true only in that very narrow area, wouldn't it be horrendous to say, well, we have got to pass a law covering lots of other areas, too.

MR. OLSON: I disagree with that. In fact, I think the underwriting restriction, if and when it comes, will be an underwriting restriction that only exists for people in industrial equipment.(p.187)

CHAIRMAN SCHWARTZ: We're getting to our own statute of limitations.

I hope they don't disappear from our view, thinking back to Professor O'Connell's opening remarks, that they have a continuing relationship with us during the course of our study. If anything comes to their attention that they regard as relevant to our study, I invite them -- and I am sure I speak for the members of the Task Force -- to bring it to our attention as soon as possible.

We don't have a long time and we have to make the best use of the best resources; and that's what we had here today.

We learned a little bit about the effectiveness of trial lawyers; that a plaintiff's lawyer can make you think manufacturers are criminals; a defense lawyer can make the tort system really like a spouse who tries as best he can to get along.

But I hope we learned -- and I know we did -- some other things, and we can express our appreciation now for our guests' attendance.(p.189)

(Applause.)

(Whereupon, at 3:40 p.m., the meeting in the above entitled matter was closed.)

Part III: Working Task Force Monographs

During the course of its study, the Working Task Force requested that several persons prepare monographs on subjects related to the product liability problem. Four of those monographs, which were of particular interest to the Working Task Force, are reproduced below.

The first three were prepared by participants in the Product Liability Symposium described in Part II above. The fourth was prepared by a Special Assistant to the Administrator of the Federal Insurance Administration of the Department of Housing and Urban Affairs. The subject matter of each monograph, as well as the background of the author, is described preceding each of the monographs.

Professor John W. Wade is a Distinguished Professor of Law at the Vanderbilt Law School and the Reporter of the Restatement (Second) of Torts. His paper, Preliminary Comments on the Products-Liability "Crisis" (1976), sets forth various suggestions as to how to ameliorate the product liability problem. He discusses: (1) actions that could be taken to make products safer, (2) modifications to the substantive and procedural rules of tort law, (3) changes in insurance procedures, and (4) various substitutes for the present tort liability-insurance system.

PRELIMINARY COMMENTS ON THE PRODUCTS-LIABILITY "CRISIS"

John W. Wade

This report to the Interagency Task Force on Products Liability is little more than a compilation of scattered suggestions. It is a curious combination of brainstorming and rehashing well-known ideas. The ideas are organized in a somewhat systematic fashion; and they may offer some different "slants" or may stimulate lines of thought on the part of members of the Task Force. I could elaborate on most of them but have not attempted to do so since their purpose is merely to be suggestive.

The comments in this report are included without regard to whether they may offer long-range or short-range assistance in meeting the purported "crisis." I have of course not attempted to evaluate the extent of the crisis. I have not tried to indicate the feasibility of the ideas, the means for their implementation, or whether they require Federal, state or individual action. The Task Force was not expecting a participant in the seminar to limit his comments to a worked-out statement of what the Federal Government should do to solve the crisis.

In preparing the comments, I have carefully studied the minutes of the seminar, but I have not re-studied the Findings of the 30-Day Commerce Study, since I assumed that the Task Force would have all of those findings fully before it. I do not feel certain that I would finally recommend some of the ideas stated in this report even if I felt that they were fully feasible. They are worth study, however. Because of the circumstances under which the Task Force was set up, my suggestions have to some extent been developed from a defendant-oriented viewpoint; but as a law teacher I have always tried to maintain an even-handed balance between plaintiff's positions and defendant's positions. That frame of mind has governed the preparation of this report.

I. ACTION TO MAKE THE PRODUCT SAFER AND TO DECREASE ACCIDENTS.

This is the most fruitful line of attack in the sense that what it accomplishes is clear gain. It decreases injuries to consumers and decreases costs to manufacturers, and does not have the effect of merely shifting the loss from one set of persons to another set. Suggestions:

(1) Find ways to obtain data and information as to the nature and frequency of injury claims against particular types of products and individual manufacturers. Neither manufacturers or individual consumers seem to be desirous of compiling the data or making them available. Can requirements for compiling the data be improved? Carefully prepared record blanks, not too onerous but still meaningful, would need to be prepared. There must be appropriate safeguards not to publicize the information or to make it available to competitors. Perhaps the rules of evidence should be changed so as to make the information not available for discovery or admissible as evidence in a personal-injury action. (There is an analogy here to the rule of evidence not permitting the admission of testimony that a manufacturer corrected a "defect"--for reasons of policy, to encourage him to make the correction.)

From these data it will be possible to deduce "patterns" for accidents and to come up with clear recommendations for action to eliminate or decrease the accidents.

(2) Carefully review the work of CPSA and OSHA. How successful have they been? Is their effectiveness improving? Are there recommendations for making it more effective?

Perhaps consideration should be given to making a compliance with certain designated requirements imposed by these agencies amount to a

ruling as a matter of law that the product is not defective or unreasonably dangerous in that particular respect. This is like negligence per se for violation of a regulation--in reverse; and some of the ramifications of that doctrine may be appropriate here, too.

(3) Arrange for appropriate persons to consult with manufacturers on how to avoid putting out unsafe products. These consultants might be private individuals engaged in this activity as a business enterprise (for a description of this type of service in connection with malpractice, see Newsweek, July 26, 1976, p. 79), or persons supplied by insurance companies (affording consultation such as that on hazards of workmen's compensation which the insurance companies advertise they supply as a service), or quality experts employed by the Government for this purpose. It might be a welcome relief to the manufacturers to have governmental officials coming to advise with them to help them, rather than to impose regulations which must be complied with; and cooperation might be more wholehearted.

It would be necessary to arrange for the manufacturers to have designated persons to talk with these advisers. For a company of any size it should be a committee having a management official, an engineer and an attorney. These committees, if established, could be very useful.

Products may be unsafe because something went wrong in the assembly line and the particular product was not screened out, or because of an unsuitable design for the product in general, or because of inadequate warnings or instructions. All of these should be treated by the advisors, and the manufacturer's committee should be trained to be alert for each of them. This committee should also give careful attention to company advertisements, to prevent liability of the company for express warranty because of the over-claims of Madison

Avenue advertising.

(4) These (or other) advisers might also carry the educational program beyond the manufacturers to the users of certain types of equipment. Warnings and instructions on how to use unavoidably dangerous equipment might prove very fruitful in some instances.

II. CHANGES IN SUBSTANTIVE OR PROCEDURAL TORT LAW

A. Basis for Liability

(1) Develop a unified basis for imposing liability. The combination of bases now--involving negligence, breach of warranty (implied or express) and strict liability--is confusing and somewhat conducive toward overexpanding the scope of liability.

(2) Confine strict liability in tort to cases in which the product is unreasonably dangerous--or not duly safe. The use of a spread-the-risk formula--finding a defendant who is in a position to spread the risk among the members of the public or among all users of the product as the sole or even primary criterion for imposing liability is not practical or sound. The present "crisis" is an illustration of how it does not work.

(3) Develop a more definite set of standards for determining when a product is unreasonably dangerous. Advert to questions like these: When is a warning or set of instructions sufficient? What about the hyper-sensitive plaintiff? What should be the useful length of life of particular products (especially durable goods) beyond which the manufacturers should be responsible? Under what conditions may unavoidably unsafe goods be placed on the market? What effect should be given to knowledge of lack of safety or of possible safety features accruing to the manufacturer and to the general trade after the product had been manufactured?

(4) Determine with more certainty the relative functions of judge and jury in determining when a product is not duly safe. What effect should be given to compliance with governmental regulations or industry standards?

(5) Treat all actions for loss of bargain--e.g., the product did not do as good a job as it should--as actions for breach of contract, and let the UCC rules (instead of tort rules) apply as to the economic loss (rather than physical injury) resulting from the breach.

B. Defenses.

(1) Comparative negligence. Adopt comparative negligence and apply it to all cases of products liability, whether the plaintiff's theory is negligence, breach of warranty or strict liability. Comparative negligence is much fairer to both parties. To avoid the unfair harshness of contributory negligence, the courts went too far in holding that a negligent user can recover against the manufacturer even though the manufacturer is not found to be negligent, if he only sues in strict liability. On the other hand, plaintiff's unreasonable assumption of risk ought not to bar his recovery completely.

(2) Limitation of actions. This needs careful study, as there are some hard problems. The tort statute should not start running until an injury has been incurred, despite the fact that the sale occurred earlier. In view of the difficulties with insurance, however, perhaps an overall "statute of rest" is warranted. What length? Should it vary for durable goods and others? Its putting a limit on tolling because of infancy or other disability may be all right.

C. Damages

(1) Develop a system for substituting periodic payments for a lump sum award when the amount is large, especially when there are

unusual uncertainties about length of life, possibilities of recovery or extent of future medical costs. This involves many problems and may be difficult to work out, but it can mean that the amount paid is much more accurately attuned to the actual injury. The need for this applies not only to products liability but also to all torts judgments involving large sums based upon uncertainties as to the future; and the National Conference of Commissioners on Uniform State Laws (NCCUSL) is appointing a special committee to study the matter and perhaps to attempt to draft a statute.

(2) Develop standards for evaluating general damages, or pain and suffering, thus producing some uniformity in this area rather than leaving the matter to the whimsicalities of an inexperienced jury. Picking a dollar figure for pain and suffering is essentially a policy decision instead of fact finding, and it should probably be done by the judge instead of a jury. In England, where this is done, the judges are developing a useful set of standards and the determinations are much more consistent. (This, too, is not peculiar to products liability.)

(3) Give careful study to the applications of the collateral-source rule. This means study as to the logic and the practical application. The studies of the Uniform Laws Committee in drafting UMVARA would be useful here.

(4) Eliminate or at least restrict, the award of punitive damages.

D. Relationship of Manufacturer to Other Possible Defendants

(1) Establish contribution between joint tortfeasors, with allocation to be determined by relative fault of the parties. This should fit with comparative negligence as to the plaintiff; and this contribution should then take the place of indemnity, which was in

many cases an "overkill", reacting against the old common-law rule against contribution. As a result of all of this, the apportionment of damages between the manufacturer on the one hand and the wholesaler, the retailer, the user and the repairer on the other will be worked out on a much fairer basis, rather than placing the whole responsibility on the manufacturer, as so often happens today. It should not ordinarily be necessary to have separate actions for contribution, if the parties are all joined in the original suit.

(2) Give careful attention to the problem when an employee is injured by a machine in the factory, as to the relationship between the manufacturer of the machine and the employer. This often produces very inequitable results today. The employer is liable only for the very limited amounts in the workman's-compensation statutes, and the manufacturer may be stuck with a far higher amount. Under the compensation statutes he is not entitled to contribution (or indemnity) against the employer--this for recognized reasons of policy.

The machine is usually a durable one with a long life. It is in connection with these machines that the "products-liability crisis" is most acute, many sources indicate. Can a different solution be worked out? Is it feasible to develop something like the following? When a workman's injury is produced by a "permanent" machine in the factory, his workman's-compensation benefits will be substantially increased. The manufacturer of the machine will not be liable in tort for injuries caused by a defective machine, but he must contribute appropriately to the increased compensation benefits. His contribution might be worked out in several ways. For example, (1) let him contribute the amount of the increase for each employee injured by the machine, (2) let him pay a premium to the compensation insurer at the time the machine is purchased and installed, (3) do not require

him to make a direct contribution but have him reduce the price of the machine so that the employer can afford to pay the increased benefits. Perhaps negligence liability should be retained for an egregiously dangerous machine.

If properly worked out, this assures the employee of more adequate compensation, provides a fairer relationship between the employer and the manufacturer and attempts to solve the area in products liability that presently seems to be the principal reason for the crisis.

(3) In a situation where it is the common desire to encourage the public to participate in using a product--as in vaccines against polio or swine flu--the government (for the benefit of all of the public) should compensate an injured consumer for harm incurred that is inherent in the project and cannot be avoided by the exercise of due care. The manufacturer's liability should continue to apply for injuries caused by its negligence. The government's responsibility would probably not apply to compensation for pain and suffering, and the collateral-source rule would not apply.

E. Matters Involving Tort Trials

(1) Make required accident reports confidential, to encourage manufacturers to keep and file them. (See ¶ I(1).)

(2) Give attention to the rules and practices involving the use of expert testimony. There are abuses here sometimes producing incorrect results, and the set-up adds very substantially to the expense of a trial. Would it be possible to borrow an idea from the so-called impartial medical panels and to find it helpful and effective?

(3) Engage in study on the relative function of judge and jury in a products-liability trial. There is little treatment by the courts of who decides whether a product is unreasonably dangerous. See ¶ II C(2) as to the assessment of damages for pain and suffering. Other instances of discretionary determination might be listed.

(4) Study the relevant aspects of res judicata and collateral estoppel--also the utilization of class actions. All of these could cut down on the number of trials and the expense involved in them. There may be some helpful ideas here.

(5) Study the whole matter of attorney's fees. The problem is not confined, of course, to products-liability cases, but is acute here. Does court control provide an answer? The relationship of the contingent fee to general damages (or recovery for pain and suffering) means that elimination of the latter would seriously hurt the injured party. Should there be set rules regarding size of verdict and amount of fees? Is the English system (having the loser pay the winner's attorney's fee) better?

II. INSURANCE AVAILABILITY AND COSTS

This is an area in which I have little expertise, and I make no claim to covering it adequately. Some thoughts:

(1) Is there point in encouraging companies that are fully responsible to become self-insurers? They become much more claim-conscious then, and have for more incentive to make the product reasonably safe. The way insurance premiums have been rising recently has had little to do with the claims record of the particular manufacturer, and the deterrent feature of tort law is dissipated.

(2) For the same reason, would it be well to arrange for policies with high deductibles--say $5,000 to $10,000, or more. The companies can handle the "smaller" claims, the relationship of claims to the safety of the product is brought home to all in the factory, and the insurance premiums may be substantially reduced. Company organizations might work out joint defense agencies for the claims within the deductible.

(3) Study the problem of excess coverage to see what opportunities it offers. This would be excess over what the self-insurer could carry, or over what the liability insurance company would expect to be able to cover. Can there be a joint underwriters' arrangement for this alone? Should the government be expected to arrange for excess coverage? This would give the government more control over the manufacturing process.

(4) The "time of coverage" of insurance policies needs careful study. Would it be useful to arrange for policies covering only products manufactured after the policy was issued? The insurance company would be able to tell more about the quality of the product then, and could more accurately assess premiums. What then could be done about the products already in use or in the market? Self insurance or a special policy?

Is it better to have a policy cover all accidents (injuries) occurring during its period or all claims made during that period? This is a point of serious dispute in the malpractice crisis. Objective study is needed.

(5) How necessary is it to require a large company to make all of its reserves available for paying products liability claims? Could just a designated amount be recognized as subject to the liability claim--and thus keep the rather hazardous (and perhaps unprofitable) liability risks from jeopardizing the reserves in the more stable lines of insurance?

IV. COMPLETE CHANGE FROM THE TORT-LAW--LIABILITY-INSURANCE SYSTEM

(1) No-fault insurance. This is first-party (rather than third-party liability) insurance. It is the type used in the automobile reparations acts. We are now getting experience with this and an objective study of how it is working would be useful. I seriously doubt if the concept

will work in connection with products liability. If every consumer had to carry his own accident insurance, the manufacturer would have no incentive to spend more money to make his product duly safe. The deterrence feature of tort law would be lost, and it is necessary.

I find myself unconvinced by Jeff O'Connell's optional no-fault system. If I understand it, it seems to me impractical. But you should consider it on the basis of his explanation.

(2) No-fault liability. This is strict liability, either tort liability of the kind in Rylands v. Fletcher, or statutory liability of the kind involved in the workmen's compensation acts. But we already have, in most states, strict liability in tort for products. It is not and cannot be an absolute liability. If it were truly strict, it would make the match manufacturer liable for all fires started by his matches, the automobile maker liable for all accidents in which his cars were involved, etc., etc. We do not do that because the costs to the manufacturer would be completely ruinous.

Workmen's compensation is more nearly of the absolute-liability type. It covers all injuries incurred in the course of the worker's employment. The restriction there is fairly easy to maintain. Liability cannot be extended to all injuries in which a product played a part. More important, workmen's compensation involved some important trade-offs. The employer gave up some important defenses (contributory negligence, assumption of risk, fellow-servant rule) and was thus able to insist on stringent statutory limits on the measure of recovery. These trade-offs are no longer available to any real degree in products liability. The workmen's-compensation approach is almost certainly not feasible as a general system in this area.

When the manufacturer's product is a durable machine that is installed in a factory on a semi-permanent basis, however, it becomes

essentially a part of the factory environment--the "place of work" for the employees there. The workmen's-compensation approach might apply to accidents in which the machine played a part and include the manufacturer of the machine for payment of increased compensation, as spelled out in ¶ IV D(2).

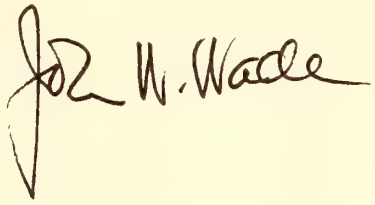
(3) Arbitration. There is little chance of having binding arbitration replace the tort-trial system in the big cases. Neither plaintiffs nor defendants would be likely to agree to it, and constitutional requirements would almost certainly be held to be violated. Optional arbitration is now available but rather seldom used in cases of large claims. A requirement of non-binding arbitration before going to trial, if found constitutional, would usually only add another step to the trial procedure, as the loser would usually insist on a trial. It is possible that a hearing before an established panel of experts (similar to the medical panels) would help in shortening the time of trial and the use of expert evidence. (See § IV E(2)).

On the other hand, binding arbitration for small claims may prove to be a very useful device. It has commonly been held to be constitutional, and it can relieve the courts of clogging litigation by a more expeditious determination. Just as important, it can make possible the obtaining of compensation in cases of comparatively minor damages in which the costs of litigation and the amount of time necessarily involved would make it not possible for a plaintiff's attorney to take the case on a contingent-fee basis.

This, of course, may have the effect of increasing insurance costs in some degree and therefore may not be regarded as within the purview of the mission of the Task Force. But I would suggest that the Task Force should regard its mission as a broader one--to seek

to find ways of reforming the current products-liability system to make it fairer to all parties concerned.

On this note I conclude my comments.



Professor Douglas G. Olson is an Associate Professor of Insurance at the Wharton School of Business, University of Pennsylvania. His paper, Selected Mechanisms for Insuring Product Liability (1976), analyzes alternative insurance market mechanisms which could be established by state or Federal government to augment or replace the private sector in the product liability insurance market. The mechanisms analyzed are: (1) assigned risk plans, (2) reinsurance facilities, (3) joint underwriting associations, (4) victim compensation funds, and (5) government insurance programs.

Selected Mechanisms for

Insuring Products Liability

Submitted to: Professor Victor Schwartz

Program Director
Products Liability Task Force
United States Department of Commerce

Douglas G. OLson, Ph.D.
The Wharton School
October 16, 1976

TABLE OF CONTENTS

Introduction 1

Assigned Risk Plans. 3

Reinsurance Facilities 6

- Distribution of Insurance 6
- Functions Performed by the Facility 8
- Premium Determination 8
- Distribution of Profits or Losses 9
- Evaluation of Reinsurance Facilities. 11

Joint Underwriting Associations. 15

- Availability of the JUA 16
- Membership in the JUA 16
- Monopolistic Versus Competitive JUA 18
- Permanency of the JUA 19
- Management of the JUA 20
- Accessibility of the JUA. 21
- Terms and Conditions of Insurance Offered by JUA. 22
- Ultimate Distribution of Possible Losses. 27
- Evaluation. 28

Victim Compensation Funds. 31

- Florida and Pennsylvania Compensation Funds 31
- Evaluation. 33

State Insurance Funds. 35

- Medical Malpractice Funds 35
- State Worker's Compensation Funds 36
- Evaluation. 36

Summary Remarks. 38

The purpose of this paper is to examine certain alternative insurance market mechanism that could be established either by individual states or by the federal government to supplement or supplant the private insurance industry in the products liability insurance market. It does not presume the need for such a mechanism. Rather, it seeks to explain the characteristics of the alternatives. The alternatives that are examined are: (1) assigned risk plans, (ii) reinsurance facilities, (iii) joint underwriting associations, (iv) victim compensation funds, and (v) government insurance programs. The first three alternatives are principally devices for restricting the freedom of the private insurance industry, while the last two are methods of eliminating the private insurance sector.

Most examples will be drawn from experience in medical professional liability. Although medical malpractice insurance problems are not identical to the situation in products liability, the two areas are parallel in many respects. In both cases, changes in tort law and other considerations have resulted in substantial increases in claims, in a manner which has been viewed as essentially unpredictable by insurance company actuaries. Both areas have been burdened with significant costs in the settlement of claims. Thus, policyholders in some segments of both the health care delivery system and industries providing goods and services have experienced rapid increases in premiums and difficulties in obtaining insurance. Both areas involve extremely difficult sophisticated and important problems of injury avoidance and claims settlement, necessitating substantial expertise. Therefore, at least from the point of view of the producer and health care provider, the problems share basic characteristics. Finally, the goals that an insurance mechanism for medical malpractice would attempt to achieve are similar to those that would be used to evaluate a mechanism for products liability.

It must be recognized that the choice of the most appropriate approach to the insurance aspect of the products liability situation must be related to the definition of the problem. In fact, it seems reasonable to conclude that the choice cannot be made without a firm identification of the specific

characteristics of the products liability insurance market that are considered to be undesirable. Hence, the following discussion is not principally designed to select any one particular approach. However, it is reasonable to conclude that the resulting system should meet certain basic criteria. And, to a great extent, decisions regarding the appropriateness of alternative mechanisms can be made on the basis of these alone. These basic criteria are:

A. To provide adequate stimulus for changes in industrial organization and activities on an individual firm level, which will impact on the frequency and severity of product related injuries.

B. To guarantee that adequate resources will be available to make reparation to victims, as defined by common law or legislation (albeit state or federal).

C. To facilitate (or at least not impede) the operation of the liability system by treating victims in an equitable manner while avoiding unnecessary payments, and

D. To avoid disrupting other economic relationships outside the products liability area.

With these criteria in mind, an analysis of alternative insurance market arrangements such as those included herein can generally be completed on the basis of seven considerations. These considerations include:

A. The extent to which the mechanism affects the pricing policy that would normally follow a private, competitive insurance market.

B. The extent to which the mechanism affects the ability of insurance companies to underwrite the individual applicant (normally interpreted as the freedom the company has to reject an applicant or refuse to renew an existing policyholder).

C. The overall financial stability of the involuntary mechanism, i.e. its ability to absorb abnormally high claims.

D. The distribution of profits and loss.

E. The ease with which insurance can be obtained from the mechanism and the efficiency of distribution.

F. The procedure for settling claims.

G. The impact of the mechanism on injury avoidance activities.

Assigned Risk Plans

Historically, the most widely adopted involuntary insurance market mechanisms have been assigned risk plans.[1] At one time this approach was almost universally used by individual states as a method of dealing with price and availability problems in the market for private passenger automobile insurance. Recently there has been some movement away from assigned risk plans to reinsurance facilities, with the latter receiving favorable analysis by the Federal Insurance Administration.[2] The operation of assigned risk plans will be illustrated in terms of private passenger automobile insurance, and then discussed in terms of the product liability situation.

Under most automobile assigned risk plans, a driver with a valid operating permit is guaranteed access to insurance. If the driver can prove that he/she is unable to obtain insurance in the voluntary market, then the driver can request insurance through the plan. In general, the driver is required to demonstrate that a reasonable attempt has been made to obtain insurance and that such insurance was either not available or was available only at a price in excess of that which would be charged by the plan. Thus the plan not only guarantees that insurance will be available, it also places a ceiling on the premium that the driver might be required to pay.

If the driver is deemed eligible by the plan, then he/she will be assigned to a particular insurance company. Insurance company participation in the plan is a condition for being licensed to issue private passenger automobile insurance. Therefore all companies that issue insurance in the voluntary market will also insure policyholders under the assinged risk plan. When a company is assigned a policyholder, the company must make insurance available under the terms and conditions specified by the particular state. At that point the company becomes individually responsible for insuring the risk. There is no pooling of results (sharing of profits or losses) among participating companies, and this constitutes one of the most important, distinguishing characteristics between assigned risk plans and other involuntary market mechanisms. As long as the driver maintains a valid operating permit, the company is typically obligated to provide insurance

for three years.

Assigned risks are distributed among participating insurance companies on the basis of their share of the voluntary private passenger automobile insurance market. The share is generally computed on the basis of the automobile insurance premium income for each company. Thus, if a company receives 20 percent of the total premiums in the voluntary automobile insurance market, it will receive 20 percent of the assignments. Companies can reduce their obligation in a variety of ways. For one, they can receive "credit" toward their obligations by voluntarily insuring a policyholder that has been placed in the assigned risk plan. They can also receive credit by voluntarily insuring certain types of drivers, such as the so-called youthful driver.

Assigned risk plans have not been viewed as particularly desirable by either agents, insurance companies, or drivers. The results for the plans vary widely. In some states, the premium income from assigned risk programs has been sufficient to defray the claims and overhead costs incurred. However, in most states (including the most heavily populated), the assigned risk plans have incurred chronic deficits. Under the latter circumstances the plans have been a vehicle by which other insureds have subsidized the assigned risk policyholders. As might be anticipated, there has been significant disagreement between the insurance companies and the different states regarding the appropriate premium charge and both the amount and breadth of insurance protection that must be made available. Companies feel that decisions are excessively dominated by political considerations, and the debates have been heated.

Insurance agents are also critical of assigned risk plans as they tend to disrupt the normal agent/company relationship. Under the plan, agents may find themselves dealing with companies with which they are not familiar, which makes transactions more difficult to complete. Finally, several analysts of the assigned risk mechanism have concluded that they provide the policyholder with service which is of lower quality than that received by policyholders in the voluntary market. Critics generally attribute this difference to the fact that assigned risk policyholders are a burden from the point of view of the company and agent, and therefore little effort is devoted to maintaining or increasing policyholder satisfaction.

Regardless of experience in the private passenger automobile market, assigned risk plans do not appear to be a particularly attractive alternative for products liability. First, it is not at all clear how such assignments would be made. This is attributable to the fact that it is very difficult to determine the relative shares of different companies in the products liability insurance market. Second, the heterogeneity of products liability problems would seem to pose a particularly difficult issue. How could an insurance company that deals principally with retail establishments for consumer goods, for example, be expected to provide product liability insurance to a pharmaceutical company or a manufacturer of industrial equipment? This would suggest the need for separate, industry by industry assigned risk plans. But this approach is undesirable for a variety of reasons. It would be administratively difficult and further, would simply stimulate individual insurance companies to avoid industries which they feel might prove to be difficult at some time in the future. Thus the plan would merely aggravate rather than mitigate the basic problem. Finally, the potential size of claims that could be incurred on behalf of a particular policyholder would also speak against the use of assigned risk plans. A single company could be allocated a substantial financial burden, significantly increasing the potential for its insolvency. This possibility results principally from the absense of a sharing of aggregate financial responsibility by participating insurance companies, and is hardly a desirable feature from any viewpoint.

Reinsurance Facilities

Patterned after relatively widespread use among Canadian Provinces to guarantee the availability of personal automobile insurance, there have been a significant number of proposals for the establishment of involuntary reinsurance facilities as an answer to insurance price and availability problems in the United States. In fact, several states have supplanted automobile assigned risk plans with reinsurance facilities.[3] Of even greater interest, three states (Arkansas, New Jersey, and North Carolina) adopted legislation permittting the establishement of reinsurance facilities as a "solution" to the medical malpractice insurance problem.[4] However, the Arkansas Insurance Department has interpreted the statute as permitting the formation of a Joint Underwriting Association (and has chosen that alternative). The New Jersey facility has been established in such a manner that it is actually much more like a JUA than a facility, and the North Carolina statute has been found to be unconstitutional by that state's supreme court.[5] This situation illustrates two conditions regarding reinsurance facilities: (i) their desirability is frequently subject to serious disagreement, and (ii) a facility can be structured in a variety of ways so that the concept is generic rather than specific. The following discussion will outline the basic components of a "pure" reinsurance facility and describe alternative formulations. It may be helpful to note that the principal motivation for the facility concept has been the difficulties encountered under assigned risk plans.

The discussion will analyze four basic considerations: (i) the distribution of insurance under a facility, (ii) functions performed by the facility, (iii) premium determination, and (iv) the distribution of profits and losses.[6]

Distribution of Insurance

Under the original concept, once a reinsurance facility has been established for a particular type of insurance, no company that is licensed to sell that insurance may refuse an applicant because he does not meet the

company's normal underwriting standards. However, the company may, at its discretion, transfer all or a portion of the obligations to the facility. Advocates of the reinsurance facility concept argue that this accomplishes two goals: (i) it relieves the individual company of the financial burden of the high risk policyholder, and (ii) it guarantees the policyholder the right to select the agent and/or company with which to do business. Furthermore, it also relieves agents of the problem of dealing with companies with which they are unfamiliar. Hence, proponents argue that there is little reason for the agent to avoid particular applicants who otherwise would be hard to place.

It is not difficult to understand why agents are vocal proponents of the reinsurance facility. In an open market, an agent might be required to exert considerable effort to search among companies to find one that will accept the high risk applicant. This problem will not occur when there is a reinsurance facility. Further, it not only allows them to place the insurance with a minimum of effort, it also allows them to use the insurance companies with which they normally do business, which is a distinct advantage over the assigned risk plan.

As in the case of assigned risk plans, companies are required to belong to the reinsurance facility as long as they issue the type of insurance identified in the legislation establishing the facility. For example, in an automobile reinsurance facility, all companies issuing automobile insurance in the voluntary market would be required to participate in the facility. However, from the point of the view of the financial stability of individual companies, the distinction between an assigned risk plan and a reinsurance facility is dramatic. Essentially, this difference is the fact that a participating insurance company will not be confronted with the entire financial burden of a particular policyholder. Companies pool the experience of all reinsured policyholders and share in the aggregate results according to some predetermined formula (which will be discussed shortly). Thus there is an averaging of results across participating companies, which would appear to be a much more equitable approach.

Functions Performed by the Facility

Although the facility acts as a distinct insurance entity, it normally performs none of the functions typically associated with an insurance company. Generally it will not have actuarial responsibilities (as discussed below). Further, it does not become involved in either loss prevention or claims settlement activities. In fact, the facility is little more than a clearinghouse. The actual management functions are provided by the individual ceding companies (i.e. the companies with which agents place the policyholders). The companies are responsible for the collection and forwarding of premiums, issuing policies, providing related services to policyholders, and adjusting claims. The facility merely reconciles accounts: debiting companies with premiums owed the facility, crediting companies with the facility's share of claims, and allocating the overall profits or losses from the reinsurance operation. Thus the involuntary facility is patterned after many types of reinsurance arrangements in the private insurance market, whereby the reinsurance company is virtually a silent partner.

Premium Determination

Another important distinction between involuntary reinsurance facilities and assigned risk plans, and between the facility and reinsurance arrangements existing in the private insurance market, involves the determination of premium rates. Under a reinsurance facility, ceding companies are left free to establish their own premium rate structure (subject to state insurance regulation). Therefore there is no common price structure as exists in assigned risk plans. Furthermore, under the original concept, the reinsurance facility has no control over the premium that it will receive for reinsurance. There is no uniform price structure applicable to reinsured risks. Rather, if a company decides to reinsure a portion or all of a particular policy with the facility, it will simply transfer a share of the premium that it charged the policyholder. For example, if a company decided to reinsure 80 percent of the policy with the facility, it would first deduct that portion of the premium that is needed to cover expenses,

and then transfer 80 percent of the remainder to the facility. In return, the facility would be responsible for 80 percent of the claims.

The alternative to the variable pricing model is, of course, one under which the reinsurance facility is permitted to establish its own rate structure while leaving the ceding companies with discretion to charge their own individual rates. In essense, the facility's premium would be only that amount which is sufficient to cover the facility's responsibility for losses and minor expenses. Under these circumstances, if the ceding company decided to reinsure a portion or all of a particular policy, it would pay the facility the same proportionate share of the facility's premium rate. Critics of this approach suggest that it would reintroduce the concept of preferred and second class policyholders that arose under assigned risk plans. Clearly this approach would not be as simple as permitting a company to pay a proportionate share of its own premium. The fixed price approach also has another characteristic. A company that has been extremely selective and developed a relatively low premium structure would, if required to accept a particular applicant, be required to pay more than it had received in premium income in order to obtain reinsurance. Of course, if the facility charged a price that was lower than that charged by a particular company, then there would be a potential advantage to simply reinsuring all business with the facility.

Anticipating the effect of either a fixed or variable priced reinsurance facility on the behavior of private insurance companies is extremely difficult. One of the key issues involves the method of allocating profits or losses.

Distribution of Profits or Losses

A reinsurance facility is treated as if it were a private reinsurance company, internally absorbing the possible losses by reductions in the assets of member companies. But, unlike a private reinsurance company, unless the facility is given the authority to establish its own premium structure, it will have no way of enforcing an increase in premiums among member companies. Essentially, it has no control over the source of the deficit.

One of the most important issues involves the formula for distributing losses among member companies. There are three possibilities. First, losses

could be distributed in proportion to the percentage of the total market (including both retained and ceded business) held by each member company. The relevant market could be defined in a number of ways. For example, it could be limited to a very few types of insurance (such as general liability insurance) or could encompass a broader scope (such as all property/liability insurances). A second alternative would be to base the distribution on the percentage of the total reinsurance premium submitted to the facility by each member company. If this were the case, a company might issue products liability coverage but not cede any portion to the facility, in which event it would not be responsible for any of the losses.

There are substantive differences between the two techniques for distributing losses. Distributing losses on the basis of the total property/liability insurance market removes a kind of "Las Vegas" overtone that would otherwise exist. If losses are distributed solely on the basis of the use of the facility, a company may find itself disproportionately involved with the facility simply because all the high risk policyholders approach it for insurance, which it cannot refuse to provide. On the other hand, distributing losses on the basis of the total market would not discourage use of the facility by insurance companies as effectively as distributing the losses in proportion to the use of the facility. More will be said about this in later discussion.

The third method of distributing losses has been devised in an effort to capture the advantages of each of the first two. Under the third approach the share of losses allocated to a company depends on that company's share of the total market and its share of the premiums ceded to the pool. This technique has been advocated by the Federal Insurance Administration.

Regardless of the specific technique, the basic measure that is used to determine a company's share of losses is the premiums that it receives for insurance. Therefore, a company's share will depend on both its premium rate and the number and types of risks that it insures. This introduces two possible problems. First, a company can manipulate its responsibility by changing its premium structure. Second, companies that voluntarily seek to insure relatively high risk policyholders thereby increase their responsibility for losses incurred by the facility even though they do not place a disproportionate share with the facility. This is counterproductive.

Evaluation of Reinsurance Facilities

Although the reinsurance facility would appear to be a relatively simple approach, it is an extremely difficult mechanism to evaluate. One aspect is clear. Since no insurance company that participates in the facility can refuse to offer coverage, accessibility is assured. However, there are at least two serious questions, which seem to be especially relevant to the case of products liability insurance: (i) whether it is desirable to establish a mechanism that would permit virtually any insurance company to issue insurance on a variety of products liability exposures at no risk to itself, and (ii) the effect of this approach on the stability of the insurance industry and hence on the price and availability of other types of insurance.

The use of a reinsurance facility as a method for solving the problem of insuring products liability would have a definite impact on the insurance market. There are two characteristics of the commercial insurance market that are especially relevant. First, in general, businesses prefer to deal with as few insurance companies as possible. This preference is motivated by a variety of economic and noneconomic considerations. Therefore, companies that do not have sufficient expertise to deal with the products liability problem are not as desirable as their competitors who do have the necessary expertise. The second characteristic is implied by the first: products liability insurance is not, as a general rule, sold independent of other coverages. It is generally combined with other liability insurances and frequently with insurance on real and personal property. Under an appropriate marketing strategy, an insurance company may earn an adequate profit on the overall risks that it insures for a business as long as the losses on products liability are relatively minor. Under these conditions, a reinsurance facility may not be a desirable approach for the following reasons.

As previously indicated, one of the basic purposes of the products liability insurance mechanism is to stimulate a reduction in the number of product related injuries. A facility would, however, permit a variety of

insurance companies to undertake products liability insurance. There is no guarantee that the company will possess the kind of expertise that is socially desirable. A producer or distributor of goods may choose a company, or be solicited by an agent of a company, that is not particularly adept. Since the facility performs none of the basic activities associated with the insurance, the policyholder will not receive the desired assistance in the sophisticated problem of product safety. One might argue that businesses will only select those carriers who possess the required expertise. However, analyses of insurance decisions by businesses suggest that this is not always the case.[7] In a free market this problem will not arise. The economics of the situation will generally stimulate an insurance company to either develop the required expertise or avoid issuing this type of insurance. The stimulus is not only competitive, it is also linked with the need to control the risk that the insurance company faces. However, with a reinsurance facility this risk can be passed to other companies.

There is an even more complex issue relating to the settlement of claims. If the company is permitted to reinsure a substantial percentage of the risk with the facility, the only stimulus it will have to refuse settlement with an unqualified claimant is the possible effect that the payment will have on its share of the facility's losses. One would imagine that this stimulus is relatively small. Unless the insurance company has a large share of the facility's policyholders, it may not view its impact as significant. In fact, it may decide that the most desirable approach is to settle claims without resistance, since it will thereby reduce claims settlement costs.

Under those facilities where the premiums are tied to those charged by the ceding companies, an individual insurance company would clearly have the opportunity to "victimize" the pool (other companies). If its rates are inadequate, it can simply force the pool to subsidize the rate inadequacy by transferring policyholders into it. An insurance company might decide to use the price and/or availability of a particular type of insurance as a marketing device, which will allow it to sell other insurance and/or related

services on which it expects to profit. In a free market, the company would be forced to absorb the losses in order to realize the gains. However, with the reinsurance vehicle present it can force the pool to participate in the losses. Since this is hardly a desirable result, insurance pools may require even more stringent regulation of insurance companies than has been required heretofore.

Advocates of reinsurance facilities as a solution to insurance price and availability propose to solve the above problems by further restricting the freedom of individual insurance companies. The solution is to require the reinsurance of all insurance written on behalf of a particular policyholder whenever the company uses the reinsurance pool for the products liability risk. Thus the possibility that the company would use products liability as a "loss leader" to gain access to other insurance would be removed. However, this would appear to be an extremely undesirable provision regarding any commercial insurance in general, and products liability insurance in specific. It is quite possible that such a stipulation will either build unnecessary costs into the insurance premium or will reduce the number of companies competing in the commerical insurance market. Neither is a desirable result. The only real solution to the problem of using the facility as a loss leader is to permit the facility to establish its own premium.

Proponents of reinsurance facilities which are tied to individual insurance company premiums assert that such a procedure will force more careful evaluation of the individual policyholder and will solve the availability problem by stimulating companies to develop adequate classification systems to accomodate the high risk applicant. Supposedly a company can reduce the costs it incurs from the reinsurance facility by minimizing the number of risks that it cannot accomodate internally. And, the best assurance of internal capability is a refined classification system. This alleged advantage suffers from both theoretical and practical problems. In fact, an analysis of the functioning of reinsurance facilities indicates that they will operate to subsidize companies that use crude classification systems at the expense of companies that have developed refined systems. To the extent that such subsidization occurs, it represents an arbitrary transfer of funds, which imposes additional costs on particular groups of

policyholders with no apparent justification. The only solution would be to allocate the losses of the pool only among the insurance companies that actually cede business. However, this poses several financing problems that make it difficult to implement. A second consideration involves the reasons for the existence of a residual market. To the extent that the residual market results from the unwillingness of regulators to permit the use of adequate rates (for political or other reasons), a reinsurance facility will hardly solve the problem. In fact, the existence of a reinsurance facility may perpetuate rate inadequacies by eliminating whatever pressures exist on insurance regulators to permit adequate rates.

It should be noted that the reinsurance arrangement in New Jersey for medical malpractice insurance is significantly different than the model outlined above.[8] In the first place, the only companies that are eligible to reinsure with the facility are those that are approved by the Board of Directors of the facility. The Board is substantially concerned with the sophistication and capacity of the company to administer malpractice insurance schemes and provide adequate loss prevention and claims settlement services. Second, although the facility does not devise its own premium rate, it does examine the rates used by the ceding company to determine their adequacy. Apparently the Board would reject the application of any company that proposed to use rates which were deemed to be inadequate.

Joint Underwriting Associations

As an involuntary market mechanism, the joint underwriting association is most frequently identified with medical professional liability insurance. At least 31 states have enacted legislation establishing authority for the formation of an association for malpractice liability.[9] However, the potential number of JUAs is much larger since many state insurance regulatory agencies believe they possess sufficient authority to establish a JUA without the necessity of specific legislation.[10]

The concept of an association is not unique to medical malpractice or even involuntary markets for mitigating problems of either price or availability of insurance. The association concept is an adaptation of an established practice in the property/liability insurance industry whereby several companies voluntarily join together to provide coverage for difficult situations (such as ocean marine, aircraft, and nuclear facilities insurance). Although the JUA has become the most popular approach to mitigating the medical malpractice problem, there is serious disagreement over whether these entities are a real solution or merely a political palliative. In fact, there is substantial opinion that the formation of a JUA may actually reduce the stimulus to find fundamental answers to insurance problems since it can be used as a camouflage and thereby reduce concern for the basic problem. More will be said about this in subsequent discussion.

In general, a JUA is no more than a method of combining the financial capacities of insurance companies to guarantee the availability of insurance. By compelling insurance companies to participate, it is possible to remove the effect of competition on the decision of insurance companies regarding whether certain insurances may be available. When a particular type of insurance appears to entail substantial risk, an individual insurance company may feel that it cannot afford to provide such insurance when its competitors may elect not to do so. The JUA removes the effect of these competitive pressures by creating a single entity, which is required to make insurance available and imposes the financial risk on all companies. In this sense, it is much like a reinsurance facility.

While the concept is simple, there are difficult decisions that must be made regarding the organization and practices of the association. There are eight

issues that must be examined in order to adequately characterize a JUA. These include: (i) availability of the JUA, (ii) membership in the JUA, (iii) whether the JUA is monopolistic or competitive, (iv) whether the JUA is to be permanent or temporary, (v) management of the JUA, (vi) distribution of insurance from the JUA, (vii) terms and conditions of insurance offered by the JUA, and (viii) the distribution of possible losses.[11]

Availability of the JUA

As a general rule, the adoption of legislation for an association has not automatically created a JUA. Rather, the legislation provides the state insurance regulatory agency with the authority to create an association if, in the determination of that agency, conditions warrant its existence. In this regard, insurance commissioners have been granted broad discretion. In the case of medical malpractice, legislation typically directs the insurance commissioner to create the association if insurance is "substantially unavailable" -- a phrase which is not defined.[12] There is no indication of how many potential policyholders must be denied insurance before the threshold is reached, or whether restrictions in the amount of coverage that is available would also qualify. Further, the phrase leaves unanswered the relatively delicate question of price. Clearly, price and availability are not totally independent considerations. There is some level at which high premiums would be equated with a lack of available insurance, but that level is not specified. The result of this discretion is that JUAs may be created in some states but not in others, even though the conditions existing in the insurance markets are parallel. It may depend on the political strength of the various interest groups that might petition the insurance commissioner to establish the JUA.

When a JUA is created, it is not necessary that it be made available to all potential policyholders. For example, a products liability insurance JUA could be made available only to firms in certain industries, only to cover certain products, only to manufacturers (as opposed to retailers, wholesalers, or suppliers of raw materials) and so forth. In other words, market segmentation is clearly possible, and the agency with discretion to establish a JUA would make the determination of "substantially unavailable" for each individual segment.

Membership in the JUA

The question of which insurance companies are required to be members of the JUA is a substantive and sensitive issue. The criteria for membership is

generally based on the types of insurances being offered by the company in the voluntary market. The choice will determine not only the specific insurance companies that will be included, but also the relative share of the risk to be borne by each company.

In theory, a products liability association could be comprised of only those insurance companies that issue products liability insurance. And, the distribution of the burden would depend on the relative share of the voluntary products liability insurance market by each member company. If a company had 10 percent of the products liability market, it would be responsible for the same percent of any deficit resulting from the association. This would be considered a narrowly defined association. As in the case of other mechanisms, justification for this approach is generally based on the theory that the JUA is a tax to be paid by those companies for the privilege of engaging in the products liability insurance market. While this philosophy may have some appeal, it seems to suffer from serious shortcomings. On a practical level it is virtually impossible to assess the relative share of the products liability market held by each company. Adopting a somewhat braoder definition based on general liability insurance would mitigate the practical problem, but would not remove the most serious considerations.

In essence, the choice of criteria that are used to define membership should be based on at least two fundamental considerations. The first of these is the financial capacity of the association and the second is the impact of the burden. Other things being equal, the possibility that the JUA will disrupt the financial condition of a member insurance company declines as the number of insurance companies increases. Further, as the types of insurances that are used to identify the insurance companies that are required to be members increases, the closer the proportionate distribution of losses will approximate the proportion of total insurance activities undertaken by each insurance company. For example, if membership were required of only the companies that issued general liability insurance, and the deficit was distributed on the basis of the relative shares of the general liability insurance market, then the responsibility of a member company may have no relationship to its relative capacity to bear the risk. The company with the greatest financial capacity may provide a disproportionately small amount of general liability insurance, and hence bear a lesser burden than its smaller competitors. This would have even further ramifications for the premiums charged by the different companies

for coverages other than products liability. In other words, it may well affect the price and availability of other insurances, and alter the competitive position of different insurance companies. Before leaving this question, it should be noted that, if a products liability association were used for only a segment of the market, then a narrowly defined JUA would be no more justifiable than one which is broadly defined.

Monopolistic Versus Competitive JUA

A JUA may be established as a monopoly, in which event it would be the sole source of products liability insurance, or as a competitive alternative to the private insurance market. In a monopolistic JUA, no insurance company would be permitted to offer products liability insurance, and all business with products liability policies existing at the time the JUA is activated would be placed with the JUA. This transfer could take place as existing policies reach their termination date, or could be made at the time of activation. Of course, a competitive JUA would still be required to make insurance available to all applicants.

The choice between a competitive and monopolistic JUA would be influenced by decisions regarding several considerations. Proponents of a monopolistic JUA argue that the only effective way to stimulate the private insurance industry to maintain full insurance availability is to deny companies any share unless they can service the entire market. They also argue that a reasonably large number of policyholders are necessary for the JUA to obtain an accurate estimate of the appropriate premiums and for financial stability, and that the only way to ensure this is to design a monopolistic association. Opponents argue that a monopolistic JUA would represent permanent government intrusion into the private sector since such a JUA would be very difficult to terminate. It would also eliminate any incentive for innovation and possibility for experimentation. The merit and significance of many of these arguments are difficult to evaluate on an objective basis.

It is clear that a monopolistic JUA would possess certain capacities that would not be available to a competitive organization. For one, a monopolistic insurance entity would not be subject to competitive pressures on pricing. Unless it is decided that policyholders in a competitive JUA are to be subsidized, the competitive form would be required to adopt a competitive premium classification system. Otherwise, other companies would simply attract the

better risks from the JUA, leaving the latter with at least temporary financial deficits. In fact, it is not possible for a competitive JUA to influence the premium classification structure. On the other hand, a monopolistic JUA would possess greater discretion over premium classes. The only pressure it would face to design a refined classification system would result from the possibility that businesses would undertake self insurance if they were not fairly prices. This alternative aside, it is possible that a monopolistic JUA could even charge all businesses the same rate. This may be a critical consideration depending on the extent to which high premiums for some businesses are viewed as a problem, If it is, then a competitive JUA can not solve that problem unless it is to be subsidized.

A second issue relates to differences in the ability to influence the fundamental characteristics of the products liability problem. By definition, a monopolistic JUA would have a much greater amount of information, and greater ability to gather a broader scope of information than a competitive JUA. This question is more complex than simply a pooling of information that is being collected by individual insurance companies in an effort to facilitate their own separate underwriting and actuarial activities. It implies the need for information gathered in a consistent and comparable fashion, and would probably entail a greater variety of information than is normally collected by insurance companies. Unless all companies could agree to such an undertaking as part of an industrywide effort, a monopolistic JUA would possess a clear advantage.

Permanency of the JUA

In the case of medical malpractice, most JUAs have been established on a temporary basis, with life expectancies of only a few years. The preference for a temporary association has been motivated by an underlying suspicion that the very existence of such an entity would tend to reduce overall concern for the problem, and that one way of eliminating that tendency is to give the association only temporary status. There is little doubt that a JUA can be used to not only guarantee the availability of insurance but also to suppress the premium rate, thereby artificially lowering the cost of product-related injuries from the point of view of the manufacturer.

JUA legislation in medical malpractice also generally provides for a second method of terminating the association. Insurance commissioners are typically

given the authority to terminate the JUA upon a finding that there is an adequate voluntary supply of insurance. Presumably such a finding would be initiated by a petition by private insurance companies. As in the case of determinating the need for a JUA, the criteria that are to be used as the basis for determining whether there is an adequate supply leaves substantial discretion to the insurance commissioner.

It is necessary to recognize that there are actually two points of termination for an association issuing products liability insurance. The first is the time at which either the legislated time period is reached or the regulatory authority determines that there is no longer a need for the JUA. The effect of this is that no new policies would be issued and existing policies would not be renewed. However, the association must continue to exist until its obligations are fulfilled, which will not occur until the last claim is settled. Thus, in areas such as products liability, the association may continue for several years after its formal termination. The length of time will be determined not only by statutes of limitations and the time required for adjudicating existing claims, but also the precise responsibilities assumed under the insurance contract. It is important to realize that the actual financial results will not be known until the association terminates as an operational entity.

Management of the JUA

In practice, one of the most difficult and important decisions in the establishment of a JUA involves the specific entity or entities that will manage the association. As in the case of any other insurance company, management will entail the appointment, supervision and compensation of agents; the collection of premiums; actuarial functions; the classification of applicants; the servicing of policyholders; and the administration of claims.

As implied in the evaluation of reinsurance facilities, there may be definite advantages to concentrating management responsibility among one or a few selected companies. Both product safety programs and claims management are relatively technical, sophisticated problems requiring a substantial amount of expertise. Among insurance companies, only the relatively large, commercial insurance carriers could be expected to possess sufficient knowledge and expertise that may be required to provide businesses with assistance in the development of product safety programs, and to monitor the operation of these

programs. In the area of medical malpractice, which faces parallel problems, there is a growing concensus of opinion that patient injuries in hospitals can be substantially reduced by inaugurating patient safety programs. And, limiting management of medical malpractice JUAs to insurance companies with experience in this area is an effective way of assuring that such programs will be undertaken. The same would be true in the case of a products liability JUA.

There is also substantial opinion that products liability claims are relatively sophisticated problems, that require significant expertise. Evaluating the potential responsibility of a supplier of products and preparation of an adequate defense are difficult and time-consuming problems, which are beyond the expertise of many insurance companies. Placing this problem in the hands of inexperienced adjusters may result in unnecessary delays and aggravation for the victim, or unnecessary payments on behalf of the insured. Neither alternative is socially desirable.

Obtaining the services of an insurance company with substantial expertise in products liability may become a difficult problem. Recent developments in the case of medical malpractice associations would suggest that insurance companies are reluctant to act in this capacity. This reluctance seems to stem from the possible legal liability of a servicing company to the other member companies.[13] If it appears that the servicing company has acted in a negligent fashion, resulting in increased deficits, or fails to act in the best interest of the association, then the other members may hold the servicing company legally responsible for the losses sustained. This might become an especially difficult problem in the case of a competitive association, where the same company is also acting as an insurance company for products liability on its own behalf. The potential conflicts of interest, and the difficulty in defending their actions, have made insurance companies wary of the problem.

Accessibility of the JUA

As implied in the discussion of assigned risk plans, one of the basic problems with involuntary insurance mechanisms has been assuring adequate access for eligible applicants. For the most part, the ease with which businesses would be able to obtain products liability insurance from an association will be determined by the ability of agents to use the association and their attitude toward it. As previously indicated, one of the alleged advantages of a reinsurance facility is that agents will encounter no barrier to its use, and therefore will have no tendency to avoid high risk policyholders. In fact, there seems to be no reason why an association should be

less accessible than a reinsurance facility. It is important that all agents who normally deal with companies that are members of the JUA be permitted to place insurance with the association. Limiting agents will simply disrupt the normal agent/policyholder relationship and create difficulties for businesses. Agents could be permitted to place business directly with the association, or could simply place the policy through the companies that they normally use. In fact, there seems to be little reason why a business should be prohibited from dealing directly with the association, if it so desires.

The last issue involves the commission paid the agent. It is frequently tempting to lower commissions paid under involuntary insurance mechanisms below the normal market rate in an effort to reduce overall cost. The difficulty with this approach is that agents are tempted to avoid the involuntary market, and to convince the insurance applicant that higher cost alternatives somehow offer higher quality services, and are therefore a more desirable alternative. Therefore, unless the association is the only source of insurance, some businesses might pay higher premiums than are actually required to obtain equal service. In this regard, it may be interesting to note that the commissions on medical malpractice insurance have declined to approximately 5 percent of the premium, and a similar rate could be expected to arise in the case of products liability insurance.[14]

Terms and Conditions of Insurance Offered by JUA

The terms and conditions of insurance offered by an involuntary insurance mechanism are always a subject of controversy. The issue contains several dimensions including, among others, the maximum amount of insurance available to any applicant, the events that are covered, the costs that are covered, whether the association is to be self-supporting, and whether the association will attempt to closely match the premium to the risk presented by the particular policyholder or will use rather broad classes which will subsidize some high risk policyholders. With regard to the latter, it should be recalled that, unless the JUA is monopolistic, it will either be forced to match premium with risk or will require subsidization.

Recognizing that one of the basic purposes of an involuntary insurance mechanism for products liability would be the protection of victims, limiting the amount of insurance to a relatively low level such as $100,000 per victim would seem to be undesirable. With regard to medical malpractice, JUAs

typically provide up to $1 million per victim, and $3 million for all victims in one year.[15] In general, the only rational approach to this question is to investigate the current losses incurred by victims in an effort to determine the percentage of victims that will be totally compensated by alternative limits.

One of the most difficult issues in products liability insurance involves the events that will be covered. Historically insurance companies have been reluctant to cover all causes of unsafe products. These restrictions have been imposed not only to limit their exposure, but also to reduce the possibility that the presence of insurance will tend to reduce a business's concern for product safety since the insurance company, and not the business will bear the direct costs. The issue is extremely complex. Generally insurance companies have not been willing to extend coverage for the costs incurred by a business for such problems as defects in design. On the one hand, such limitations may be understandable from the viewpoint of an insurance company. Design defects may give rise to a sudden onslaught of a large number of victims, thereby threatening the financial stability of the insurance company and the protection of its remaining policyholders. Further, there is little doubt that any tendency of businesses to reduce their concern for safe products because of the presence of insurance is not socially desirable. However, from the point of view of the victim, the question of whether the loss was the result of carelessness in the design of the product, testing the product, or in the production process is not particularly relevant. The solution to this conflict is not readily apparent. But it is clearly worthy of further analysis aimed at determining both the extent of product related injuries that are not covered by virtue of these limitations and alternative solutions.

An issue which is not unrelated to the limitations discussed above is the fact that insurance coverage for products liability will not cover all of the costs incurred by a manufacturer arising out of unsafe products.[16] For example, insurance contracts frequently exclude the costs of recall, repair, replacement and/or destruction of unsafe products. And, insurance companies will not reimburse a business for the loss of revenues that it may sustain because the market suddenly perceives its products as being unsafe. The motivation for these exclusions is, among others, the same concern that providing a business with total protection will tend to reduce attention to product safety. Since these limitations do not impair the ability of the victim to receive compensation

for injuries, there would seem to be less justification for modifying current practices from the viewpoint of public policy. They are noteworthy for two reasons. First, the excluded costs may be sufficiently large so that, even if insurance were extended to cover defects in design and related activities, businesses would have little tendency to be less concerned with product safety. Second, the fact that a business does not receive restitution for the costs incurred for recall, repair, replacement and/or destruction may make it much less willing to undertake such activities. The fact that businesses have expressed concern over the absence of such coverage is noteworthy. If the absence of coverage has this effect, then it is clearly undesirable since unnecessary avoidance will lead to an increase in the incidence of product related injuries. The situation focuses attention on the need for further analysis and on the regulation of businesses to assure adequate recall activities.

Another consideration that seems to be of increasing importance involves the question of whether the insurance will follow the product or will be limited to the time for which the contract is written. In fact, there are three possibilities. The simplest approach, from an insurance standpoint, is to limit the coverage to claims of which the company is notified during the period of coverage (typically one year).[17] Protection is provided regardless of whether the item was manufactured in this or in previous periods. The approach is simplest from an insurance point of view because it permits the underwriter to escape from the business without carrying forward unknown obligations. It also eases the actuarial problem because the only values that must be estimated are for the claims that are already present. This reduces the length of time for which projections must be made into the future and eliminates any problems of unknown claims. This coverage would be referred to as a pure claims made policy.

A second approach to coverage is to include any injuries that occur during the policy period (for which the business is legally responsible), regardless of when the product was produced and regardless of when notification of the claim is actually received. From an actuarial point of view this is more difficult than a pure claims made policy since, in determining the costs that are being incurred, it is necessary to make allowance for claims that are literally unknown, Further, since many of the claims will not have been submitted, the

projections to determine the ultimate cost must be made further into the future. Estimating the impact of inflation and the attitude of future juries is a notoriously difficult problem, so the distinction between pure claims made and the second approach is not trivial. The actual significance of the difference will depend on statutes of limitations and the tendency of victims to submit claims as soon as they are aware of the injury.

The third approach is to tie the coverage to the product. In other words, the claims for which the insurance company would be responsible are those that are attributable to items that are produced and/or distributed during the policy period -- regardless of when the injury occurs or is submitted for consideration. The distinction between this and the previous approach would be trivial in the case of products that are consumed rapidly, but would be dramatic for products with relatively long life expectancies. The actuarial projections required in the case of durable goods would be difficult for reasons which have been previously discussed.

It should be apparent that approaches that reduce the uncertainty from the point of view of an insurance company increase the uncertainty from the point of view of the policyholder and victim. One of the basic difficulties is that, under the current procedure, the protection afforded future victims in the case of businesses that cease doing business and/or cancel insurance coverage is questionable. If a producer ceases to exist, claims that are incurred in the future use of the items produced by the manufacturer will not be covered by the last insurance company. This results in what I have previously referred to as a legacy of uncompensated victims. At the present time this problem is principally limited to the demise of durable goods manufacturers. But, if there is a shift to a pure claims made approach (and there is fragmentary evidence that such a shift is occurring), then consumers of virtually any type of product face the potential problem of uncompensated injuries resulting from the retirement of a manufacturer.

The design of a JUA must include consideration of this issue. Its importance is underscored by the fact that, if the choice is not carefully made, it will be even more difficult for a business to make the transition from the JUA to the voluntary market.

The questions that normally receive the greatest amount of attention, and are subject to the greatest controversy, are whether the association is to be self-supporting and whether the association should employ refined premium rating systems that attempt to match premiums with the claims potential of individual policyholders. In the case of medical malpractice JUAs, the decision

seems to have been made in favor of self-supporting associations with premium classification plans that parallel those used in the private insurance industry. However, since the rates charged by such associations are subject to regulation by state insurance commissioners, it may be difficult to anticipate the actual outcome.

The motivation for self-supporting associations with relatively refined premium classifications is the argument that has been traditionally used by proponents of accurate pricing systems. Policyholder activities designed to reduce the number of occurrences that result in losses (injuries) are best stimulated by an accurate premium rating system that rewards successful efforts by policyholders and imposes the full costs incurred in meeting the insured obligation. Conversely, if premiums do not reflect the differences among policyholders, so that some are subsidized by others, those who direct more dangerous activities will not be adequately stimulated to undertake programs. designed to reduce the danger. Further, an accurate premium rating system will assure that the prices of more dangerous activities will more closely approximate the actual social cost that is associated with them, thereby supporting the private market system and provide appropriate signals to consumers.

The argument regarding accurate premium rating systems must address some rather complex problems. First, it is possible that creating high insurance premiums for some businesses will encourage them to adopt some alternative other than insurance. They may undertake self insurance programs for which inadequate financial preparation is made to meet future obligations to victims of product related injuries. This problem may, of course, be mitigated by regulating such activities. However, there is a more complex issue which regulating self insurance activities will not address.

The argument for accurate premium rating systems is based on the assumption that the rates reflect current decisions regarding the safety of products. This is not the case, however, with products liability insurance for some industries. The important point to recognize is that insurance premiums are linked with the obligations undertaken by the insurance company. These obligations may or may not reflect current decisions. The result depends on the promise in the insurance contract in conjunction with the nature of the product. It should be recalled that the most widely used promise is to protect a business for claims incurred during the policy period -- regardless of when the item was produced or distributed. Thus, the current premium for a business that has been producing

durable goods for a substantial period of time will reflect decisions made in premiums periods. This poses two issues. First, a particular manufacturer may be held responsible for errors in judgment which appear to be faulty only on the basis of hindsight. In other words, at the time the decisions were made, they appeared to be appropriate by any reasonable measure. Therefore the manufacturer will face extremely high costs even though current output meets the highest standards of safety. While this would not be a problem in a stable environment, products liability is a notoriously volatile area. Second, a new manufacturer's premiums will not be as high as one that is relatively old even though the new manufacturer's product may be more dangerous than that produced by the older competitor. To the extent that the differences in premium are significant, "accurate pricing" unnecessarily disrupts the economic order. The whole issue is worthy of serious consideration.

Medical malpractice JUAs have attempted to assure that they are self-supporting by not only targeting for accurate premiums, but also by the creation of so-called stabilization reserves. These reserves are created by assessments u pon policyholders, and the funds are used to absorb excessive losses. The funds belong to the policyholders and, in the event that they are determined to be unnecessary after a reasonable period oftime, they will be returned. The same approach could be used in the case of products liability JUAs.

Ultimate Distribution of Possible Losses

Most, if not all JUAs have been created on a nonprofit basis. In the event that profits develop, they are to be returned to the policyholders in the form of dividends. Given this condition, associations have also been instructed in such a way as to minimize the possibility that large deficits will develop that must ultimately be borne by other policyholders in the member companies. Two mechanisms have been established to avoid this contingency. First, it is possible to permit the JUA to levy retroactive assessments on policyholders if a deficit should develop. If claims and overhead expenses arising out of the obligations assumed in a certain period are in excess of the premium income, policyholders in that period are liable for assessments to meet the deficit. This assessment is generally limited in amount. Unfortunately this approach may encounter practical difficulties. It should be recalled that deficits are not generally known until several years after the policy has terminated. If a policyholder is no longer insured under the JUA, collection

of the assessment may be difficult. Assessments will be impossible if the business is no longer in existence. Finally, as the association grows older and some policyholders have been insured therein for several years, they may find themselves facing multiple assessments reflecting deficits occurring in several previous years. This possibility underscores the need for an adequate premium.

A second mechanism for meeting the deficit has been to permit member insurance companies to offset the deficits against premium tax obligations owed the state. Thus the costs are redistributed to state taxpayers. Premium taxes are generally equal to 1 to 3 percent of the premiums received from policyholders in the state. Each company is permitted to offset its share of the deficit against its premium tax obligations arising from all insurances issued in the state -- not just products liability insurance. When the association can assess policyholders as well as use the premium tax offset, the latter would be used only if the assessment provision is not adequate.

Evaluation

For reasons explained in the preceding discussion, it appears that a JUA could, of appropriately structured, be a much more desirable alternative than an assigned risk plan or reinsurance facility. However, the analysis also suggests that some alternative forms are preferable to others.

As indicated on several occasions, the choice of insurance companies that will provide management services to the association is an extremely important consideration. The need to guarantee that adequate assistance is available to businesses in the development of product safety programs can hardly be overstated. Discussions with brokers and analyses of businesses' attitudes would suggest that even some relatively large businesses require assistance in the development of product safety programs. The servicing company(ies) representing the association should be actively involved with this problem and possess the required expertise. If it is not possible to find an insurance company with the necessary skills, then the association should be instructed to contract for this service with another entity that does possess the necessary capabilities.

In addition to assuring that assistance is available for the development of product safety programs, the use of a small number of servicing companies would facilitate the development of the data needed to better define the products liability problem. And, the need for expertise in the administration of claims

would further underscore the desirability of using only companies with developed expertise in the products liability field. As indicated, inept claims management can only magnify an already burdensome problem.

There seems to be good reason for believing that the base of insurance companies included as members of the JUA should be as broad as possible. If products liability is a social problem, then the base over which deficits are distributed should also be broad. All property and liability insurers should be included. Only in this manner is it possible to avoid arbitrarily favoring some insurance companies over others, and distributing responsibility in accordance with both equity and the ability to bear the risk.

A third consideration is the distribution of losses. If the association is to be established on a nonprofit basis, then it seems reasonable to presume that there should be some protection from long run deficits. Policyholder assessment is an obvious alternative, but suffers from particular problems. Where the deficits are not known for several years, collection of the assessment may be difficult. Even worse, if the association is competitive and has only a few insureds, it is neither practical nor equitable to attempt to immediately recoup deficits on the basis of assessments. In fact, it seems reasonable to presume that the assessment power of the association will be limited, whether the association has a substantial number of policyholders or only a few. Using a tax offset for at least some of the ultimate deficit seems to be the only realistic alternative. It is a much more equitable arrangement than placing the burden on the other policyholders of the member companies, which is otherwise an inevitable economic consequence.

In a choice between a monopolistic and a competitive association, it would seem that the latter is the only reasonable approach. Trying to establish a monopolistic association would encounter difficult definitional problems and would also seem to be undesirable from the point of view of businesses. It is not clear how one would decide for which businesses the association would be the only source of products liability insurance. And, the attitude of businesses toward their insurance arrangements would suggest that most would prefer to continue dealing with the insurance company(ies) from which they have purchased other coverages if the existing relationship is reasonable. However, it would also be desirable to retain the monopolistic association's advantage in its ability to gather and disseminate information regarding the nature of the product safety problem. Therefore, the association should be given the authority to require individual insurance companies to gather and

submit data that the governing board deems to be useful. In fact, the association should be instructed to undertake such activities.

Victim Compensation Funds

One of the most curious mechanisms that has arisen from the medical malpractice insurance problem is the so-called patient compensation fund. In practice, such funds have been only slightly different than a state operated insurance company. The precise motivation for the funds is not always clear, and it may be that they are designed to achieve a variety of objectives. Although the benefits or costs are subject to conjecture, victim compensation funds have been given serious consideration by many state legislatures in the area of malpractice. By March of 1976, at least seven states had enacted patient compensation funds, and an additional 18 were considering them.[18] The basic notion of a patient compensation fund could easily be extended to the victims of unsafe products, and state legislatures may be expected to reconsider this approach if they view the products liability situation as sufficiently serious.

Although victim compensation funds may appear to be an approach that would be desirable from the point of view of the private insurance industry, it should be noted that insurance companies have generally opposed them.[19] To the private insurance industry, such funds represent government encroachment which it believes is unnecessary and imposes additional costs in the overall system. Further, it has been alleged that the funds tend to give an unrealistic impression that such problems as high medical malpractice insurance premiums are easily solved since the initial costs are unrealistically low and the assessments or premium payments by policyholders are artificially suppressed. Indeed, these devices are difficult to evaluate. In an attempt to clarify the situation, the following discussion will concentrate on the patient compensation funds enacted in Florida and Pennsylvania.[20] It should be noted that both states have also enacted legislation providing for JUAs for medical malpractice, illustrating that victim compensation funds and involuntary insurance mechanisms are not mutually exclusive alternatives.

Florida and Pennsylvania Patient Compensation Funds

The typical practice in patient compensation funds is that such funds make payments only for claims in excess of a certain threshold. The threshold in Florida is $100,000. Thus the fund is not involved in any case which is less than $100,000, and is only responsible for the payments in excess of $100,000 in the larger cases. Thus the provider is left with the responsibility for all losses on any claim to the extent of the first $100,000 in payments.

In order to qualify for protection under the Florida fund, a health care provider must either purchase insurance covering the first $100,000 of a claim

or establish a qualified self-insurance program to meet these costs. Hospitals are required to be covered by the fund unless they purchase substantial excess insurance. Hence, one of the results of the legislation is that hospitals must be financially responsible by either insuring their obligations or establishing a viable alternative. For individual providers of health care, participation in the fund (and the benefits of its protection) is voluntary.

The fund is financed by an initial assessment of $1,000 per individual participating health care provider and $300 per bed in each participating hospital. Subsequent annual fees are to be determined on the basis of actuarial considerations regarding the adequacy of the existing fund. There is also a provision for retroactive assessments of participating providers to cover any deficits. Both the future fees and assessments may be differentiated on the basis of risk classifications and the actual claims experience of a particular provider. In the case of individual providers, the fee and assessment classification systems are not as refined as the premium classification systems in use by the private insurance industry. Therefore there will be some subsidization across health care providers. The assessments can not be greater than the annual fee, and the fees and assessments are controlled by the insurance commissioner.

In the settlement of claims, the Florida fund acts as an insurance company. Private insurance companies and self-insured providers are required to notify the fund whenever they are notified of a claim that may be reasonably expected to exceed $100,000. At that point the fund may undertake its own defense. If the fund incurs liability in excess of $100,000 on any claim, then it has the authority to pay the claim in installments of $100,000 per year until the claim is satisfied. If the fund should exhaust its finances, then it will simply stop paying claims until the next year.

Overall, in some aspects the Florida fund is nothing more than an insurance company providing excess protection. However, its procedure for allocating the costs of claims and the options that it may follow in the settlement of claims makes it significantly different.

The Pennsylvania fund operates in a slightly different fashion. In Pennsylvania, health care providers are required to purchase liability insurance and to participate in the victim compensation fund as a condition of licensing. The minimum limits for acceptable liability insurance are $100,000 per occurrence, $300,000 annual aggregate. The Medical Professional Catastrophy Loss Fund is established for two purposes: to provide for payments on claims in excess of

$100,000, and to pay the entire cost of a claim arising out of a health care action more than four years before the claim is filed. The maximum dollar obligation of the fund is $1 million per occurrence, with an aggregate annual limit of $3 million per health care provider. Therefore responsibility will fall back on the provider for any claim in excess of $1.1 million. This situation creates three layers of responsibility, and potentially involves three separate administrative entities.

Financing for the Pennsylvania fund is provided by a surcharge on the premium charged the provider for basic insurance coverage. The surcharge is adjusted to reflect actuarial considerations of fund solvency, however it cannot be greater than 10 percent of the insurance premium for the first $100,000 of protection. This is clearly contrary to the recommendations of the actuaries from the Pennsylvania Insurance Department, who indicated that a surcharge in excess of 19 percent would be required to maintain solvency. The statute provides that if, after two years, the assets of the fund fall below $7.5 million, it will discontinue operations. From that point the fund would retain the right to assess providers in the event that monies are needed to meet fund obligations.

It appears that all claims arising during any year are held until year end, at which point a comparison is made between the assets and obligations of the fund. In the event that there are insufficient monies to meet obligations, existing resources will be apportioned among claimants, and the deficits will be carried over into the next year.

Evaluation

In principle, the concept of a victim compensation fund is readily adaptable to the products liability situation. Furthermore, it may be an effective method for stimulating financial responsibility by businesses (as in the Florida patient compensation fund). And, it may be an effective political mechanism for lessening the resistence to mandatory financial responsibility (which appears to have been the case in Pennsylvania). However, as these funds have been established, they possess distinct characteristics which may not be desirable. Funds established on either the Florida or Pennsylvania model may result in substantial subsidization of policyholders and may camouflage the severity of the fundamental problem. And, it may be that injured victims will be providing this subsidization. It should be noted that at least some health care providers in Pennsylvania have so little confidence in the fund that they have continued to purchase insurance as if the fund did not exist.

With regard to its impact on the problems faced by the private insurance industry, it is clear that such a fund may substantially reduce the actuarial

difficulties by limiting the maximum claim and, in the case of the Pennsylvania model, restricting the problem of delayed claims. In theory, both of these restrictions would serve to increase the availability of insurance. And, the concept of limiting the insurance company's responsibility to claims arising within a few years of the distribution of a durable good would have a very favorable impact on the insurance problem. However, a victim compensation fund essentially precludes (or at least discourages) insurance companies from providing full protection.

State Insurance Funds

As implied in the previous discussion, victim compensation funds are a subtle form of state insurance companies. Aside from these mechanisms, there is precedent for full state insurance funds in both medical malpractice and worker's compensation. In fact, the worker's compensation funds are the most widely known application of state insurance funds. Six states have established monopolistic funds (which are the sole source of worker's compensation insurance in the state) and 12 states have state funds that compete with private insurance companies.[21] In medical malpractice, at least two states (Indiana and Michigan) have established state residual market funds.[22] For the most part, the operation of state worker's compensation funds resemble the operation of a private insurance company. However, the operation of the medical malpractice funds are substantially different.

Medical Malpractice Funds

The Indiana fund is available to health care providers only after the provider has been rejected by two insurers. The fund is supported by both policyholder premiums and state tax revenues. Management of the fund is provided by the private insurance industry.

The Brown McNeely Insurance Fund in Michigan is a more complex mechanism. The fund is activated in a manner similar to a standby JUA. A category of health care providers may petition the insurance commissioner to activate the fund on its behalf. If the commissioner determines that insurance is not available or is too costly in the voluntary market, then the fund will be activated. The commissioner sets the rates to be used by the fund. To date, physicians comprise the only group that has qualified. The fund insures about 2,500 physicians. Approximately 5,000 physicians continue to be insured by private insurance companies.[23]

The Brown McNeely fund has no surplus, i.e., relies on premium income to meet claims costs, with no buffer fund to absorb inherent premium inadequacies or adverse fluctuations in claims experience. Instead, the legislation provides that if the fund incurs a substantial deficit then it can assess physicians. In fact, it can assess both the physicians that are insured by the fund and those that are insured by private insurance companies. In the event such an assessment is required, it will give rise to very difficult problems of

collection -- to which no one seems to have given adequate consideration. This problem aside, it is clear that such assessments could be substantial. The rates charged by the fund are less than 50 percent of those recommended by the insurance industry. Assessments seem inevitable.

State Worker's Compensation Funds

It is noteworthy that no state worker's compensation fund has been enacted since 1925. Further, there is some indication that the popularity of such funds is diminishing.

For the most part, both competitive and monopolistic state funds have adhered to the concept of refined premium class plans. In other words, there is no concerned effort to use the funds as a method of subsidizing particular policyholders at the expense of others. Furthermore, both the competitive and monopolistic state funds are required to be fully self-supporting. There seems to be no intent to subsidize the funds out of state tax revenues. In fact, it is not even apparent that the state government would rescue an insolvent state fund. Therefore, from a financing point of view, state worker's compensation funds are similar to private insurance companies.

It seems that the state worker's compensation funds were principally motivated by a belief that they would be much more efficient than private insurance companies and that they would be much more concerned with the welfare of workers. Overall it does not appear that such funds have been any more actively involved with the development of injury prevention programs than the private insurance industry. In fact, some analysts believe that they have been less concerned with this issue. With regard to efficiency, it is clear that the overhead expenses or transactions costs of state funds have been somewhat less than expenses incurred by the private insurance industry, but the issue is clouded. For example, unlike private insurance companies, most state funds frequently pay no premium taxes.

Evaluation

Regardless of the current structure of insurance funds used in medical malpractice and worker's compensation, the issue is the potential differences between the capacity of a government facility for products liability insurance versus alternative approaches.

In general, there is little indication on either a theoretical or experience basis for believing that there are differences in the potential for efficiency. For the most part, differences in transactions costs between those incurred by insurance companies and government insurance programs are attributable to differences in the methods of distribution. Most government insurance programs that do not rely on administrative services provided by the insurance industry use a direct method of marketing rather than agents or brokers. Since pure government insurance programs do not actively compete in the market, but rather rely on either a residual market or monopolistic position in a market in which insurance is a required purchase, comparisons are fallacious. For that matter, any involuntary mechanism could be made available only on a direct solicitation basis, including a JUA. But, it is not clear that this alternative is desirable.

The only remaining bases of comparison are the potential differences for either the subsidization of products liability costs in general, or subsidization of specific industries, and the ability of the funding mechanism to absorb unanticipated losses (financial stability). On both bases, government programs have a clear advantage. Through its taxing power, government may distribute the burden of subsidization in a more equitable fashion than to distribute it indiscriminately among policyholders of homeowners, automobile or other insurances. However, in the case of products liability insurance, the practical significance between the risk bearing capacity of the property/liability insurance industry and government is not significant. As a percentage of existing policyholders surplus or the total premium income of the industry, product liability payments are not large enough to suggest that there is cause for concern. So long as the involuntary mechanism that is adopted is broadly based, the capacity can be harnessed. Therefore, the only significant distinction is the efficiency of subsidization. The Brown McNeely fund provides an excellent example of how government programs have a greater capacity to achieve subsidization than would be available to the private insurance industry.

Summary Remarks

One of the most difficult issues that must be addressed in the formulation of an involuntary insurance program will be the question of state versus Federal. The interstate nature of the products liability problem faced by large manufacturers and distributors of goods would suggest that uncoordinated efforts by individual states could result in significant conceptual and administrative difficulties. This is one of the most important distinguishing features between the products liability and medical malpractice insurance problems.

The issue can be made clear by hypothesizing a particular manufacturing situation. Assume that a manufacturer has plants in several states that are used for the purpose of assembling the finished product, several other plants that manufacture component parts, and a distribution that includes not only a number of states but also other countries. With which state association would the risks be placed? Will the business be forced to deal with all state JUAs under a rule by which responsibility is allocated on the basis of where the product is sold? Many manufacturers would find this to be extremely burdensome. Not only would the manufacturer be forced to do business with many entities (each with its own separate requirements), but many would not be able to provide the information necessary to do so. Manufacturers frequently cannot document the actual distribution of the product to the consumer. And, subsequent resale of durable goods would be a particularly thorny issue. Furthermore, states have differed with regard to the amount of insurance that involuntary mechanisms are required to provide in the case of medical malpractice, and the same situation might arise in products liability. If this occurred, the manufacturer would face increased difficulties in trying to coordinate additional coverage purchased in the voluntary insurance market.

One might conclude that the obvious answer to these difficulties would be that the manufacturer insure its responsibility through the association in the state in which the manufacturing was completed. This would reduce, but not eliminate the basic problem. Further, it is possible that states would impose a requirement that businesses demonstrate their financial responsibility. Unless there is cooperation among states, the definition of what satisfies the financial responsibility requirement will vary. If the state in which the product is manufactured does not provide insurance in its association that will satisfy the financial responsibility requirements of all the other states in which the

manufacturer does business, additional problems are introduced.

Another consideration relating to the interstate nature of the problem involves the use of premium tax offsets as a method of distributing the ultimate deficit from a JUA. It is unlikely that a state would embrace the possibility that its tax receipts could be subject to substantial reduction because of the deficits arising out of the products liability claims against a large manufacturer distributing goods on an interstate and international basis. Therefore, deficits may be forced back on other policyholders in the member insurance companies.

The international issue is one that affects more than simply the question of a state versus Federal approach. The basic question is whether the mechanism should be required to provide insurance covering international responsibilities. The question involves not only the size of the obligation, but also the complexity. Other countries have widely differing definitions of a business's responsibility for product related injuries, which would have to be adequately evaluated by the JUA. It is not clear whether the concern for the international problem is sufficiently great to require that United States insurance companies assume the risk, with the attendant possibility that it would interrupt the price and availability of insurance in the domestic market. In any event, it seems unlikely that state governments would establish JUAs that would provide this coverage.

A second issue that is worthy of consideration is the type of insurance that is to be provided by the involuntary mechanism. Traditionally, JUAs have limited their activity to insuring policyholders on a direct basis. They have not been structured to provide reinsurance. The significance of this consideration is principally focused on captive insurance companies which are owned by an individual business or by an association of businesses. Captive insurance companies generally face one particular difficulty -- they may be financially unstable. The ultimate stability of such companies will rest on their capitalization and their ability to obtain adequate reinsurance. In general, as products liability claims and judgments increase in size, the problems that have been encountered in obtaining insurance in the direct market will spread to the reinsurance market. Since the ability to guarantee adequate reimbursement to victims is one of the principal issues, the inability of a captive insurance company to obtain adequate reinsurance would be a serious concern.

The solution to this problem is straightforward. JUAs could also be required to provide reinsurance. Such reinsurance could be limited to captive insurance companies, or could be made available to all insurers. The reinsurance premium should be actuarially sound, and this activity should be fully self-supporting. As a corollary, regulation of the financial stability of captive insurance companies would extend to an evaluation of whether the company has obtained adequate reinsurance. If it has not, then it could be forced to do so through the association.

FOOTNOTES

1. An interesting discussion of assigned risk plans is provided in: U. S. Department of Transportation, Insurance Accessibility for the Hard-To-Please Driver (Washington: U. S. Govt. Printing Office, 1970), 31-49. Also, U. S. Department of Transportation, A Study of Assigned Risk Plans (Washington: U. S. Govt. Printing Office, 1970).

2. Federal Insurance Administration, U. S. Department of Housing and Urban Development. Full Insurance Availability (Washington: U. S. Govt. Printing Office, 1974).

3. J. Finley Lee and Roger A. Formisano, "Automobile Insurance Markets: Developments in the Reinsurance Facility Technique," The Insurance Law Journal, No. 624 (January, 1975), pp. 9-26.

4. The National Conference of State Legislatures. A Legislator's Guide to the Medical Malpractice Issue (Washington: National Conference of State Legislatures, 1976). pp. 4-6.

5. Hartford Accident & Indemnity Company v. Ingram, 226 SE2d 498 (1976).

6. An analysis of various aspects of the reinsurance facility is provided in: Federal Insurance Administration, U. S. Department of Housing and Urban Development. Full Insurance Availability, pp. 78-88.

7. Michael E. Hogue and Douglas G. Olson. Business Attitudes Toward Risk Management, Insurance and Related Social Issues (Philadelphia: The Wharton School, 1976), pp. 138-159.

8. Discussion with Warren P. Cooper, Vice President and Actuary, INA Corporation and former industry advisor to the National Association of Insurance Commissioners.

9. National Association of Insurance Commissioners, Malpractice Claims, Vol. 1, No. 3 (September, 1976). pp. 78-94.

10. The National Conference of State Legislatures, Op. Cit., p. 5.

11. See also: Bureau of Insurance, Virginia State Corporation Commission. Medical Malpractice Insurance in Virginia: The Scope and Severity of the Problem and Alternative Solutions (Richmond: State Corporation Commission, 1975). pp. 41-52. J. Finley Lee and Roger A. Formisano, "Residual Markets in Automobile Insurance: The Service Center and the Joint Underwriting Association Approaches," The Insurance Law Journal, No. 625 (February, 1975), pp. 92-99.

12. National Insurance Coordinating Committee on Medical Malpractice, "Model Plan of Operations for JUA's" obtained from: Vincent J. Sachar, American Mutual Insurance Alliance.

13. Discussions with Warren P. Cooper, Vice President and Actuary, INA Corporation and former industry adviser to the National Association of Insurance Commissioners.

14. Discussion with Lester L. Rawls, Insurance Commissioner for the State of Oregon and member, American Bar Association Commission on Medical Professional Liability.

15. Information supplied by: American Insurance Association

16. Irwin Gray, Product Liability: A Management Response (New York: American Management Associations, 1975) pp. 123-134. Discussions with agents/brokers indicate that these types of exclusions continue to exist.

17. An interesting discussion of this type of approach in medical professional liability is provided in: Special Advisory Panel on Medical Malpractice, State of New York, Report of the Special Advisory Panel on Medical Malpractice (New York, 1976), pp. 225-229.

18. Information supplied by American Bar Association, Commission on Medical Professional Liability. Also: American Insurance Association, "A Study of the Patients Compensation Fund Concept and its Role in the Medical Malpractice Liability Insurance System."

19. Ibid, p. 12.

20. Pennsylvania House Bill 1367 (1975) as amended by Senate Bill 1569 (1976). Florida House Bill No. 1267 (1975) as amended by Senate Bill No. 586 (1976).

21. A thought provoking analyses of state workers' compensation funds is provided by: Wage and Labor Standards Administration, U. S. Department of Labor, Insurance Arrangements Under Workmen's Compensation, Bulletin No. 317 (Washington: U. S. Gov't. Printing Office, 1969).

22. Michigan Senate Bill 507 (1975). Indiana House Bill 1460 (1975).

23. Information supplied by Frank B. Hall Company, Detroit, Michigan, which manages the Brown McNeely Fund, under contract from the State of Michigan.

Professor Walter Y. Oi is the Chairman of the Department of Economics at the University of Rochester. He has served as a consultant to the Rand Corporation and to the National Commission on State Workmen's Compensation Laws. He has done considerable research in the area of product and work-place safety. His paper, Products Liability and Industrial Safety (1976), focuses on the economics of liability assignment and industrial consumer product safety.

August 26, 1976

Products Liability and Industrial Safety

by

Walter Y. Oi
University of Rochester

Over the course of the last two decades, the liability for accident costs generated by defective and dangerous products, has slowly been shifted from consumers (caveat emptor) to sellers (caveat venditur). This move toward strict producer liability was confined to producers of final consumer goods. The adjustments to this shift in liability assignment appeared to be accomplished with relatively little disruptions for these producers. However, in the last few years, the doctrine of strict liability has been extended to producers of durable industrial goods such as power presses, tractors, extrusion equipment, etc. Based on the fragmentary data in the Commerce Staff Report, we have experienced a significant increase in the number of litigated cases as well as sharp advances in the judicially determined accident costs in each case. Rapidly rising premium expenses for sellers in combination with cancellations of products liability insurance policies have created a state of financial crises for the sellers of some products. The issues that prompted the establishment of this Task Force are amply described in the Department of Commerce Staff study. The Task Force has been asked to propose remedies which can provide both short-term and long-term resolutions to these products liability problems.

I have limited my remarks in this paper to the economic issues concerning liability assignment and industrial consumer product safety. The propositions which I plan to develop in the course of this essay can be summarized as follows:

1. "Safety at any cost" is only a slogan, and society willingly accepts many risks in order to obtain the benefits of the related activities.

2. A socially optimal risk level is one which minimizes the sum of accident costs and accident prevention costs.

3. Judicially determined losses in litigated cases tend to overstate the true social costs of accidents for at least three reasons: (1) valuations are made after the accident instead of before, (2) valuations of lives and limbs are inextricably linked to named victims instead of to "statistical" un-named persons, and (3) jury awards tend to be larger, the wealthier is the defendant.

4. Under consumer liability, buyers do consider the expected accident costs in choosing among different qualities of risky products. If consumers' perceptions of risks and accident costs are accurate, consumer liability leads to socially optimal risk levels.

5. If private insurance markets achieve less than a socially optimal level of insurance protection, consumer liability may not be optimal. At least five arguments have been advanced to support this position: (1) people systematically underestimate the risks and/or accident costs, (2) society must collectively make some decisions because many people do not know what is in their own best interests, (3) some people do not buy insurance because they believe that society will bear the accident costs, (4) private insurance may not be available for some risks because of the moral hazards wherein the acquisition of insurance affects the likelihood of the insured events, and (5) private insurance markets fail to achieve sufficient differentiation so that each person (or seller) does not face premium rates that reflect his risks.

6. When consumers must bear the accident costs, they clearly have an incentive to exercise "due care", but the importance of this on the overall frequency/severity of accidents has been disputed.

7. Under strict liability, sellers are forced to offer tied packages consisting of the product <u>plus</u> a full coverage insurance policy. The product price must now cover the premium expense for the damages incurred by the <u>average</u> customer.

8. If sellers can discriminate and charge higher prices to customers who incur higher damage costs, [assuming such costs can be ascertained], a shift to strict liability will not affect sales of different product qualities, and risk levels will be unaffected.

9. In the absence of price discrimination, strict liability is likely to drive out the more hazardous but less expensive products thereby tending to lower accident costs but raise accident prevention costs. Further, it will redistribute wealth away from customers who suffer low damage costs to those who incur high accident costs.

10. When full insurance protection is part of the tied package, customers have no incentive to exercise "due care", and they have some incentives to inflate their estimates of damages in the event of accident.

11. In the area of industrial safety, we have more knowledge about the factors associated with the frequency/severity of accidents at work. The California data show, for example, that manufacturing industries, which use more machine intensive production techniques, do not exhibit higher injury frequency rates, although this association must be submitted to more careful empirical research.

12. Under a tort system, courts must decide whether the accident was "caused" by a product defect on a cse by case determination. We do not have scientifically determined estimates of the fraction of injuries "caused" by defective products, and we thus are unable to judge whether or not the courts are reliable in their determinations.

13. The proposal that manufacturers be required to satisfy certain mandatory inspection/certification standards, may not be consistent with the minimization of the sum of accident and accident prevention costs. Earlier attempts to lower work injury rates via safety standards have not proven to be effective.

14. The proposed remedies that would limit losses imposed on sellers could be criticized on the ground that reducing such costs would encourage the production of more hazardous products. The pertinent relationship is not between the size of losses and accidents "caused" by one class of machines, but rather, the relationship between the size of losses and the frequency/severity of all work injuries.

15. The adoption of comparative negligence is likely to impose incredibly exacting demands on the courts and juries who must not apportion the blame for each litigated accident case among all parties--the defective product, the employer who designed the workplace, actions of the injured worker, actions by fellow-workers, etc.

I. On Optimal Risk Levels

Accidents are the unavoidable byproducts of economic activity, and the costs that they inflict upon victims and property, are the prices that we pay to get the benefits from the associated primary activities. The direct accident costs can surely be reduced by engaging in various accident avoiding actions. Some preventive acts [like installing safety guards, using protective equipment, etc.] entail easily indentifiable costs. But other actions [like slowing the speed of an assembly line or substituting liquified natural gas for underground coal since the latter involves more work hazards] involve indirect opportunity costs of preventing accidents. Numerous examples can be cited where we have individually and collectively elected to incur some risks because the benefits of the associated activities outweighed the probable accident costs. But we repeatedly read that consumers and workers are exposed to "unreasonable hazards" and "unacceptable risks." How do we decide when a risk is or is not "unreasonable?"

In his book, The Costs of Accidents, Calabresi (1970) argued that public policies should try to minimize the sum of accident costs A and accident prevention costs B. Applications of this simple rule serve to define the concept of optimal risk levels. A risk level can be said to be optimal if it minimizes the sum of accident and accident avoidance cost (A+B). This minimum is attained when the marginal gain from lower direct accident costs is just equal to the marginal cost of preventing accidents. The two kinds of "costs" must be correctly defined and measured before judgements can be made about whether any particular risk level is or is not optimal.

Over the last few years, the judicially determined losses from accidents attributed to defective products have climbed at alarming rates. Are these losses indicative of the true economic costs of these accidents? The losses in litigated cases are likely to exceed the true accident costs for at least three reasons:

1. The appropriate measure of accident costs should involve ex ante valuations which tend to be well below the ex post valuations. The subjective value V which A places on the loss of an arm, is not invariant to the risk π of losing his arm. Calabresi (1970) argues that V tends to rise as π is increased; i.e., if A believes that the chances of losing an arm have doubled, he will also raise his subjective valuation V for the loss of his arm. Hence, in retrospect, [after he has lost his arm], A attaches a higher value to his arm than he did when he accepted the lower risks before the accident.

2. The value of a statistical life or limb is less than the average of the values of named lives and limbs. When we accept risks, it is as though we participate in a lottery. The implicit values attaching to life or limb pertain to some un-named individual. If we were told in advance that Charlie Brown would lose his leg, Charlie would never participate in the lottery. When the victim is identified, the valuation of the "cost" of a life or limb necessarily involves circumstances that are peculiar to that person as well as the inflation in ex post valuations. The point is illustrated by Schelling (1968) in his example where society will spend thousands to save Johnny who is trapped in a well, but the same society will refuse to appropriate funds to install a traffic light which with "statistical certainty" will save two Johnnys each year.

3. Jury awards seem to be influenced by the perceived "ability to pay"; i.e., awards tend to be higher, the larger is the perceived wealth of the defendant. If this conjecture is valid, judicial determinations of losses should not be used to measure accident costs, because the losses will be biased for richer defendants.

It has been argued that any long term resolution of the products liability problem must begin with the product itself. Policies must be adopted that will reduce the frequency and severity of product-related accidents. This line of argument assumes that products are presently "unreasonably hazardous" so that any outlays for accident prevention will be less than the reduction in direct accident costs. The assumption will obviously be challenged, and there are obvious empirical tests that can be constructed to assess the validity of the assumption.

There are some risks that we are prepared to accept even though these risks may entail substantial accident costs. It is possible to get "too much" safety which from society's viewpoint is just as costly as "too little" safety. In determining optimal risk levels, the direct costs of accidents should be measured by ex ante valuations of statistical lives and limbs. Jury awards are likely to be substantially larger than the true economic costs so that use of judicial estimates of losses would imply excessive levels of safety.

II. Equilibrium Risks Under Consumer Liability

In an earlier study, I examined an imaginary world in which the liability for product-related accident costs was assigned to consumers. Aside from cases of fraud and negligence, manufacturers were relieved of any financial responsibility. Each unit of a risky product is viewed as a package wherein the consumer gets either (a) a safe, non-defective unit Z with probability $1-\pi$, or (b) a devective unit D with probability π. Each defective unit inflicts a damage or accident cost of V dollars where V varies across consumers. Since only a fraction π of all units is defective, the accident cost that can be assigned to each unit X of the risky product will be less than V, the accident cost (valuation) in the event of an accident. If the risk can be insured, the actuarially fair premium per dollar of protection is simply $y=\frac{\pi}{1-\pi}$. Risk averse consumers will choose to demand full coverage protection and individuals suffering higher accident costs V will demand larger policies. With insurance protection, the accident cost per unit of X is thus converted to a certain premium outlay of yV where yV is larger for persons suffering higher accident costs V.

The consumer in our model can choose from among several grades or qualities where higher quality grades (meaning smaller fractions π of defective units) command higher prices. Since $y=\frac{\pi}{1-\pi}$ is smaller, the smaller is π, the consumer can lower the expected accident cost yV by buying a higher quality grade. However, higher qualities command higher prices P for units of the parent good X. The consumer is thus faced by a choice wherein he can exchange (a) lower accident costs yV by buying a product with a smaller fraction of defectives π vs. (b) higher accident prevention costs in the form of the higher price P which he must pay for superior quality. It is shown in Oi (1973A) that a rational consumer will demand a product quality π which minimizes the full price P* of a non-defective unit where P* is the sum of the price for a unit of X and the expected accident cost yV.

$$P^* = P + yV = P + \left(\frac{\pi}{1-\pi}\right)V$$

It will be noticed that minimization of the full price P* is equivalent to the Calabresi rule, namely buy that product grade which minimizes the sum of accident costs A = yV plus accident prevention costs B = P.

Consider an imaginery world of informed consumers who (i) know the various product risks π, (ii) can accurately gauge the damages V in the vent of a defective unit, and (iii) are able to spread the damage cost V through self-insurance or market insurance. In such a world, if liability for damages is assigned to consumers, the observed equilibrium risk levels (and their associated damage costs) will be socially optimal. Several arguments have, however, been advanced to support the thesis that private insurance markets typically achieve less than a socially optimal level of insurance protection. These can be summarized as follows:

1. People systematically underestimate the risks or as Calabresi puts it, "Such things always happen to the other guy, and no amount of statistical information can ever convince the individual that they can happen to him." [see Calabresi (1970) p. 56]. Tversky and Kahneman (1974) present an impressive array of statistical evidence which supports this theme of underestimation.

A variant of this theme is that even if individuals knew the actuarial risks, they are "psychologically unable to cope with them." The event, be it the loss of life or limb, is too awesome for rational estimation of the damage cost V. Underestimation of either the risk π or the damage cost V can result in less than optimal insurance protection. Moreover, the downward bias in the percieved accident cost may prompt individuals to demand riskier products.

2. The paternalism theme argues that because people are shortsighted, inept, or just stupid, society through the state must collectively make some decisions for them. People are allegedly happier when someone else makes decisions that force them to set aside part of their incomes to pay for the contingent costs of illness, accident, death, or retirement. The implication here is that people do not know what is in their own self-interest, but society somehow does. It seriously questions the doctrine of consumer sovereignty that the individual is best able to judge for himself what is or is not in his own self-interest.

3. Some individuals may not buy insurance because they believe that they will not have to bear the accident cost. Society or the state will pick up the medical bills and subsistence costs in the remote event that they are seriously injured. Such "free riders" thus impose external costs on the rest of us who make up a charitable society that is unwilling to let them suffer the consequences of their improvident behavior.

4. Private insurance markets are often unavailable when the acquisition of insurance is likely to affect the probabilities of the insured event. Arrow (1969) refers to this case as "the confounding of risks and decisions," but Pauly (1968) in his discussion of medical care insurance, refers to it under the more familiar label of "moral hazard". There are some reasons to suspect that damages due to defective products may fall into this category, at least for some products.

5. Private insurance markets often fail to provide sufficient differentiation. Individuals (or different product lines) who have vastly different accident propensities are often placed in the same risk category. Insurance rates will thus be "too high" for some and "too low" for others resulting in non-optimal demands for loss spreading.

Up to this point, I have tacitly assumed that the product risk is either inherent or can only be influenced by the manufacturer. Once the product passes to the user, the probability of an accident π is the same for all users. But the magnitude of the risk π and the size of the damage cost V can surely be reduced if the user practices various accident avoiding actions. In their final report, the National Commission on Product Safety (1970) contended that the extent to which consumer will exercise "due care" [both in their choice of product grades and in the subsequent use of those products] cannot be appreciably influenced by information or liability assignment. A somewhat different view was offered by McKean (1970) who writes:

> "The buyer is in a better position than anyone else to know the exact use to which he plans to put the product and what alternative qualities or degrees of safety in the product will mean to his costs and gains. The customer, if he is liable, has an extra incentive to acquire and make appropriate use of information. To get the information, he must deal not with thousands of individuals, but with the seller and a few other identifiable person." [p. 619]

III. Some Implications of Strict Producer Liability

For analytic purposes, let me assume (i) that the accident risk for a given product grade is the same for all users, (ii) that safer product grades meaning lower accident risks can only be produced at higher unit costs, and (iii) that the contingent accident cost V due to a product-related accident varies across consumers. The first assumption allows us to ignore the issue of "due care" on the part of users, at least for the moment.

Under consumer liability, those buyers who suffer high accident costs V find that they are better off by buying safer product grades even though this means higher accident prevention costs in the form of higher prices. However, some individuals will prefer to demand the less safe grades because they suffer low accident costs. Suppose now that the legal system is altered to one of strict producer liability wherein the seller is legally obligated to compensate customers for all damages V that they may suffer in the event of a defective unit [meaning a product-related accident]. This shift in liability assignment means that the manufacturer is forced to offer a tie-in sale consisting of the potentially risky product X plus a full coverage insurance policy where the size of the policy V varies across customers. The price $\bar{P}$ at which he offers to supply the good must now cover both the marginal production cost MC plus the premium cost to cover the actuarial expenses of the full coverage insurance policies.

$$\bar{P} = MC + yV = MC + \left(\frac{\pi}{1-\pi}\right)V$$

If the seller could discriminate among buyers, he would obviously charge higher full prices $\bar{P}$ to customers who would suffer higher accident costs V. If such discrimination could be costlessly enforced, and if there were many potential producers, we would end up with the same full prices P* and mix of product grades that would have been produced under consumer liability.

The more plausible world is one in which sellers charge the same full price to all cusotmers either because laws prevent price discrimination (even when it is justified by cost differences due to differing size insurance polices) or the inability of seller to determine the user's damage cost V. In such a world, the supply price $\bar{P}$ must cover the marginal production cost plus the mean premium expense $y\bar{V}$ where $\bar{V}$ is the mean accident costs across all consumers. Clearly, $\bar{V}$ depends on the mix of customers, but when the customer can get the same insurance protection irrespective of the product grade he purchases, he no longer has any incentive to substitute higher prevention costs for lower expected accident costs. Producer liability would thus seem to favor the increased production of safer, higher quality products. Thus Buchanan (1970), p. 66 writes:

"Let us now assume that legal rulings begin to make producing-selling firms fully liable for all damages arising from the usage of either quality of a product. In order to absorb the increased costs of this new liability arrangement, the market price for both qualities of coal will increase, but the market price for the low quality coal will increase much more dramatically. The imposition of strict liability will effectively prohibit firms from marketing a quality of product that inherently involves a relatively larger buyer-user risk. In our example, the low quality product will disappear from the market in an economic sense. It will be impossible for demanders to purchase a quality of product that does not embody full insurance as a part of the price."

McKean reaches a similar conclusion; confer McKean (1970), p. 623. When there are two grades of the risky product, the more hazardous product grade will be driven out of the market <u>if and only if</u> the mean damage cost across all consumers, $\bar{V}$ is greater than the critical damage cost V* at which a buyer would have been indifferent between the two grades. The proof of this conclusion can be found in Oi (1973A), pp. 16-17. Indeed, it is conceptually possible that a shift to producer liability could drive the safer product grade out of the market if the mean damage cost $\bar{V}$ is less than the critical damage cost V*. But this is the exceptional case, and in general, a move to strict producer liability can be expected to yield the following results:

a. The more hazardous product grades (meaning larger risks π) are likely to be driven out of the market thereby tending to reduce accident costs, $A = yV = \left(\frac{\pi}{1-\pi}\right)V$.

b. But this reduction in accident costs is achieved at a higher accident prevention cost in the form of higher costs for the production of the safer grades.

c. Since all buyers pay the same full price $\bar{P}$ for the tied package of the product plus a full coverage insurance policy, strict liability unavoidably redistributes wealth away from those buyers who suffer low accident costs V (and who would have purchased the cheaper more hazardous grades under consumer liability) toward individuals suffering high damage costs.

These implications presume that the damage costs V can be accurately ascertained and that the product risks do not depend on the actions of the users. Under strict producer liability, buyers have no incentives to exercise due care if <u>all</u> damage costs are paid by the producer. Indeed, they would have some reasons to inflate their estimates of damages inflicted by defective products. These tendencies would discourage the production of inherently riskier products where the risk of injury π can be substantially influenced by accident avoiding actions on the part of the consumer.

IV. Defective Products and Industrial Accidents

Up to now, the discussion has been concerned with the safety of final consumer products--snowblowers, bikes, shampoos, flammable pajamas, ladders, etc. But the products that were responsible for the establishment of this Task Force are not final consumer products. They are, instead, durable producer goods like stripping machines, forklift trucks, mechanical power presses, drilling equipment, etc. The principal concerns deal with the rising costs and availability of insurance protection for manufacturers of industrial equipment.

It has been asserted, for example, that the frequency and severity of industrial accidents are greater in machine intensive industries. To the best of my knowledge, no one has tested the validity of this assertion. The accident agent which was associated with each work-related injury, (but not necessarily the cause of the accident). The nine leading accident agents in 1970 for work-related injuries in California are tabulated in Table 1. It seemed reasonable to suppose that the fraction of injuries associated with machines would be larger in industries where machinery was more intensively used in the production process. I arbitrarily chose categories 1, 2, and 4 in Table 1 as machinery-related accident agents which, for all industries, accounted for 20.25 percent of all disabling work injuries. Two indexes were constructed from the California data; $M_1=A/T$ and $M_2=A/S$ expressed as percentages where A = injuries due to machinery, hoisting apparatus, and hand-tools, T = all injuries, and S = all injuries less injuries whose accident agent was either miscellaneous or not reported (category 10).

The second index M_2 assumes that the miscellaneous not reported injuries were proportionally distributed across the other nine accident agent categories. The two indexes were measured by the averages for the three years, 1966, 1968, and 1970, while the injury frequency rate for the i-th manufacturing industry Y_i represented the average for the five years, 1966-70. These data for the 19 two digit manufacturing industries are presented in Table 2. The two lowest values for M_1 were in Chemicals and Petroleum Refining, probably because only the most important accident agent was identified for each disabling work injury. In six industries, over 40 percent of all injuries, [M_1 in Table 1] were associated with machinery-related accident agents, but the injury frequency rates Y in these six industries ranged from a low of 15.7 per 1,000 workers in Apparel to a high of 96.5 in Lumber. When I estimated the simple linear regression equation, $Y_i = \alpha + \beta M_{1i} +$ error, the least squares estimate for B was 0.734 with a t-value of 1.11 and a coefficient of determination of $r^2 = .0672$. The fit was even worse, [$r^2 = .0257$] when I replaced M_{1i} by the second index of machine intensity M_{2i}. The results were virtually identical for the log-linear functional forms. No firm conclusions can be drawn from these simple regression equations based on aggregate industry data. I have not controlled for the influences of other variables that effect work injury frequency rates. Indeed, when the percentage of female workers was added in a multivariate regression equation, the goodness of fit rose from $r^2 = .0627$ to $R^2 = .3343$. When the data for eleven Service industries were examined I found that their mean injury rate was lower, $\bar{Y} = 21.1$ per 1,000 workers, and that they exhibited a lower index of machine intensity,

$\bar{M}_1$ = 16.1 percent. The production processes as well as the sex composition of employed persons are very different from those manufacturing. Finally, it should be emphasized that the data of Table 2 only show how machine intensity was associated with the injury frequency rate across manufacturing industries. The data tell us nothing about the fraction of industrial injuries that were "caused" by defective industrial machines.

Industrial accident researchers have established some interesting empirical relationships between the injury frequency and such explanatory variables as age, sex, race, occupation, labor turnover, working conditions, time of day, firm size, etc. An excellent survey can be found in Surry (1971) and a briefer review appears in Oi (1974).

Given the massive quantities of data that have been collected by many State Workmen's Compensation Agencies and by OSHA, one might think that we ought to be able to estimate the fraction of all industrial accidents which were "caused" by defective equipment. Such estimates are not available. When causation or fault is determined on a case by case basis, financial and personal situations of victims and defendants unavoidably influence outcomes. Objective scientific research of large samples of accident records would enable us to develop estimates of the fraction of injuries that were truly "caused" by defective products where the determination of "cause" is not confounded by knowing the identities of victims and manufacturers. These scientific estimates would give us benchmarks against which one could compare the overall reliability of judicial determinations of accidents due to defective equipment.

Several participants at the Symposium on Product Liability conducted by the Department of Commerce on July 21, 1976, argued that any long-term resolution of the products liability problem must involve policies that will reduce the frequency and severity of product-related accidents. With respect to consumer products, the National Commission on Product Safety (1970) contended that a move to strict producer liability was in the public interest because manufacturers were in a better position to achieve product safety. This contention could not be refuted or verified because no one had the statistics showing what fraction was the result of unsafe (defective) products, and what fraction was the result of unsafe acts by users. Although our knowledge about the factors responsible for industrial accidents is far from adequate, we have had the opportunity and the data to evaluate earlier public programs that tried to lower the frequency/severity of industrial accidents.

The mandated standards path to occupational safety was tried in several states fully 15 to 20 years before the establishment of OSHA in 1970. In New York, an extensive safety inspection program [similar to the target industries program discussed by Smith (1976)] was launched in the mid 1950's to enforce compliance with mandated safety code rules. The injury rates in the heavily inspected industry (foundries) fell in the first few years, but these improvements were subsequently eroded away in the next decade. If an injured worker could show that his injury resulted from a safety code rule violation, he became eligible for supplemental benefit payments under the Wisconsin State Workmen's Compensation laws. In the three years, 1964-66, less than 2 percent of all compensable cases received these supplemental benefits, but the percentage was higher for the

more serious injuries--around 7 percent. In another New York study of 3,216 accidents, it was discovered that a standards violation was present in 23 percent of these cases. Further discussion of these studies can be found in Oi (1975). These remarks are, I believe, pertinent to an evaluation of the several remedies. Under one proposal, part or all of the losses suffered by the injured party could be shifted from the manufacturer to the employer who owns the equipment if the manufacturer can show that the employer was negligent. The impact of this proposed remedy should be examined in conjunction with the doctrine of comparative negligence.

Another proposal would relieve manufacturers of industrial equipment, who meet the mandatory inspection/certification requirements, of liability for damages. In effect, the liability for accident costs would be returned from the equipment seller to the owner-firm or the user-worker. The mandated standards for certification as well as the inspections that will presumably enforce compliance with those standards will presumably reudce the frequency/severity of equipment-related injuries. The empirical evidence to date suggests that the standards path to occupational safety has not been effective; confer Oi (1975) and Smith (1976).

Other proposed remedies are intended to reduce insurance premium costs by limiting losses for product-related injuries. The impact of these proposed remedies will depend on the nature of the empirical relationship between the size of the claims V [which is the gross accident cost imposed upon the seller] and the frequency/ severity of product-related industrial injuries. It might appear, at first blush, that larger claims would reduce the frequency/ severity of industrial accidents. With larger claims, the producers of the more hazardous machines would face larger advances in insurance premium costs thereby driving them out of the market. However, when all adjustments to higher claims costs are considered, the conclusions become fuzzier.

Suppose, for example, that there were two kinds of packaging machines. As premium costs rise, the more hazardous type of machine could be driven out of the market. Some firms that previously demanded the more hazardous machine may not choose to shift to the safer but more expensive packaging machine. They may, instead, shift to other, more labor intensive means of packaging their products. Although the operators of the hazardous packaging machines are no longer exposed to risks, firms are now employing more unskilled, inexperienced workers in thier packing sheds. The injury toll could well increase when the more hazardous packaging machines are replaced by more labor intensive production methods.

Statutory limits on product-related industrial injuries similar to workmen's compensation, arbitration of claims, or limiting the size of lawyer's fees involve not only the issue of efficiency or socially optimal risk levels, but also the equity issue. One must also examine the impacts of these proposals on the extent to which firms and workers will exercise "due care" in using the industrial equipment.

Finally, the doctrine of comparative negligence would seem to bring us closer to the goal of socially optimal risks which minimize the sum of accident costs and accident prevention costs because it can, in principle, give the "right" incentives to all parties, [equipment sellers, employers, and workers] to exercise "due care". However, the actual implementation of this system must be more carfully examined. A fault system must assign "fault" meaning that it must determine the cause for every litigated accident case. Conceptually, accidents are "caused" by objects, people, and random chance or some combination of these. I argued earlier, [Oi (1973B), pp. 56-59] that the fault system minimized the importance of random chance. Further, there is reason to suspect that the cause is more likely to be assigned to objects rather than people. Transitory actions and events that cannot be reexamined or easily monitored, are less likely to be singled out as causal factors. Some auto accidents are surely "caused" by the failure to keep one's eyes on the road. After the crash, we can examine the wreckage and the road, or we may even get eye witness accounts of movements of other cars. But, if we are unable to observe whether or not the driver kept his eyes on the road, how can we attribute the blame to this unobserved event? The problems and possibilities for errors are greatly magnified when courts and juries are asked to apportion the blame for an accident among product defects, improperly

designed workplaces, and negligent acts on the part of the injured party or fellow workers. I suspect that the administrative costs of implementing a system of comparative negligence would be extremely high, especially when we consider the judicial costs of subsequent appeals.

With respect to consumer product safety, anecdotal evidence can be gathered to support the claim that consumers are ill-informed about the risks and accident costs associated with the use of consumer products. Strict liability presumably provides producers of consumers goods with incentives to hold back products which are "unreasonably hazardous". Are these arguments equally valid for industrial machinery and equipment? Are the firms that purchase these machines ill-informed about the risks and costs associated with different brands? The answers to these questions will indicate whether there is a valid basis for treating industrial products differently from consumer products.

In closing, I believe that it is important to remember the goal of economic efficiency when we evaluate the various remedies that are being proposed to "solve" the products liability problem. There is some danger that policy-makers will attach too much weight to short-run considerations of reducing premium costs for equipment producers. Policies that limit losses, shift liability back to employers/workers, or provide subsidized insurance protection, [possibly through Federal insurance or reinsurance programs] can obviously aid in promoting the survival of equipment sellers. But are these policies also consistent with the goal of minimizing the sum of accident costs and accident prevention costs?

The fourth monograph, Some Comparisons Between the Medical Malpractice and Product Liability Problems (1976), was written by Eli P. Bernzweig.*/ As its title indicates, Mr. Bernzweig's monograph compares these two problems in an effort to identify common solutions. His paper is especially interesting because of the perspective he gained as the Executive Director of the staff of the Commission on Medical Malpractice of the Secretary of the Department of Health, Education and Welfare. That Commission's report, published in January 1973, described the medical malpractice problem and set forth 20 specific recommendations for implementation by the Federal government.

---

*/ Mr. Bernzweig is currently a Federal Executive Fellow at the Brookings Institute.

SOME COMPARISONS BETWEEN THE MEDICAL MALPRACTICE AND PRODUCTS LIABILITY PROBLEMS

by

Eli P. Bernzweig, J.D.*

The growing public interest in the problems surrounding products liability insurance for manufacturers of capital equipment and consumer goods, leading to the establishment of the Interagency Task Force on Product Liability, invites a renewed look at the still-festering medical malpractice problem to determine if these two major issues have elements in common which might point the way to some common solutions. This paper represents an attempt to draw some comparisons and note the dissimilarities between these issues for the purpose of obtaining a better perspective on the common-solution thesis.

We shall begin with a discussion of the problem similiarities, followed by some general comments and observations on the subject. The malpractice and products liability problems are similar in the following respects:

a. Both have escalated to the rank of national problems and are widely discussed in the popular and trade media.

b. Both achieved public prominence as a result of

---

* Special Assistant to the Administrator, Federal Insurance Administration. The views expressed herein are those of the author alone, and are not intended to reflect any official position of the Federal Insurance Administration.

problems of insurance cost and availability.

c. Both malpractice and product claims have been increasing in frequency and severity, along with higher insurance premiums for the policyholders in each category.

d. The consequences of both problems have led to dysfunction in the marketplace, albeit to different degrees.

e. The paucity of credible insurance data has hindered the ability to draw conclusions regarding the magnitude and intensity of the two problems.

f. Higher insurance costs invariably have been passed on to the public at large in both instances, sometimes directly and sometimes indirectly.

g. Though affected by these added costs as well as in other ways, the public as a whole has not been significantly involved in voicing its concerns or in demanding an active role in the problem-solving process.

h. The pressures for reform in both instances have come almost entirely from those interests responsible for causing injuries or insuring against them rather than interests representing the injury-receiving public in general.

While the malpractice and products liability problems each have become matters of national concern, the latter appears to have achieved crisis status (if, indeed, that is what it is) far more suddenly than the comparable malpractice insurance

crisis. As far back as the mid-fifties, doctors in California were experiencing serious liability insurance problems,[1] as evidenced by the following excerpt from a 1959 article on the malpractice problem which appeared in the Saturday Evening Post:

> "Unquestionably, the malpractice problem has become one of the most serious in the modern practice of medicine. Medical authorities have described it as shocking, humiliating, and dangerous. One Los Angeles hospital official stated only two years ago, 'The situation is becoming acute in many parts of the Nation, but in Los Angeles it is already intolerable.' Last year the head of a special AMA committee claimed, 'The situation now has become critical and is very nearly out of control.'"[2]

One would hardly suspect that those dire remarks were written so many years ago. Clearly, California was experiencing more problems at that time than any other State, but even a cursory review of the malpractice literature would reveal that insurance cost and availability problems have been plaguing doctors and hospitals in many States for several decades.[3] What distinguishes the present state of affairs from these earlier intermittent malpractice crises is not the fundamental nature of the problem, but its pervasiveness.

By contrast, the liability insurance problems of products manufacturers are of relatively recent vintage. Undoubtedly, problems unique to a specific manufacturer or a specific type of enterprise have ebbed and flowed over the years, but it was not until a year or so ago that official industry

pronouncements began heralding the upcoming crisis in product liability insurance. As late as October of 1975 the president of the American Insurance Association (AIA) was able only to speculate whether the then problems in medical malpractice would be repeated in the products liability lines.[4] Absent any concrete data to support a more definitive assessment, he was hardly in a position to do otherwise. That the situation had not yet become a "crisis" as recently as February of 1976 is disclosed in a letter to the Commerce Department by another official in the AIA wherein the latter commented: "The insurance industry is increasingly concerned over problems which are developing with respect to products liability * * * *These problems are just emerging and we feel it is desirable to provide remedies before the situation becomes serious* * *" (underscoring added)[5] However, the current situation may be characterized, it has certainly captured the attention of the popular press,[6] the Congress,[7] and the public as a whole. The creation of the Interagency Task Force itself is indicative of the seriousness of the problem from the vantage point of the Administration.

Turning to the matter of claim frequency and severity, it is clear that the trend for both malpractice and products claims is steadily rising, though there is a marked difference in the magnitude of the respective problem areas. The best

available data --- and obtaining hard data is a problem in itself --- indicates that something on the order of 20,000 - 25,000 malpractice claims are filed annually, while estimates of the number of products claims are generally in the range of 500,000 to one million.[8] The average incurred loss for malpractice claims is approximately $15,000, while the average products claim loss is said to be approximately $100,000. If these figures are substantially accurate, then products claims are certainly more costly and more potentially ruinous to products manufacturers than malpractice claims are to doctors and hospitals.

Despite the commonality of certain factors which may be contributing to the rise in claim frequency and severity for malpractice and products claims,[9] it is reasonable to assume that the rise in products claims is at least partially attributable to several major pieces of Federal legislation which focus on the rights of consumers in the products safety area: the Flammable Fabrics Act,[10] the Federal Hazardous Substances Act,[11] the Poison Prevention Packaging Act,[12] the Occupational Safety and Health Act,[13] and the Consumer Product Safety Act.[14] So far, no Federal statutes in the health area have provided any analagous stimuli to sue doctors or hospitals for substandard treatment, and none appears to be in the offing. As we shall see later, the vast number of patients who suffer

medical treatment injuries is infinitely greater than the number who are currently bringing malpractice claims, so a steady increase in malpractice claim frequency is a foregone conclusion without any legislative influence.

The build-up of claim frequency and severity, however, is not limited to the medical malpractice and products liability lines. The trend is now becoming apparent in the general liability lines as well as in other professional coverages (lawyers, architects, engineers, accountants) fiduciary coverages, and municipal liability coverage.[15] Some have referred to this spate of liability claims as a litigation explosion or revolution.[16] Thus, the frequent comparisons drawn between the products liability problem and the still-festering medical malpractice problem tend to mask the widespread nature of rising claims in all liability lines.

Similarly, one should not too hastily equate the difficulties recently experienced by doctors in finding available sources of professional liability coverage with availability problems facing products manufacturers. The relatively thin market for physicians -- a true "crisis" in many areas of the country in 1974-75 -- has no parallel in the products area, where considerably more companies are still offering coverage, albeit at rapidly rising rate increases and with extremely selective underwriting. In short, comparability between the

products and medical professional liability lines clearly is more a matter of price than availability.

A significant distinction between the products and malpractice fields lies in the relative consequences to the public of rising insurance costs or complete insurance unavailability. When doctors in California, New York, and Florida reacted to enormous premium hikes in 1975 by staging walkouts of varying periods, for all practical purposes the health care delivery system(s) in those areas completely broke down. The withdrawal of all but emergency medical services left the public angry and frustrated, and nearly forced some hospitals to file for bankruptcy for lack of operating funds.[17] To describe this situation as chaotic would hardly be indulging in hyperbole, and in some areas, the aftereffects of these doctors' strikes are still being felt.

By contrast, when individual products manufacturers faced with crippling rate increases or the inability to obtain coverage have chosen to go out of business, the consequences to society as a whole have not been nearly as cataclysmic. For the most part, manufacturers have been able to adjust product prices sufficiently to meet the additional premiums they must pay -- something that physicians and hospitals find harder to do under the rather inflexible third-party payment systems which govern the bulk of their billings.[18]

One can state with little fear of contradiction that the lack of authoritative and credible statistical information has been a major problem for those seeking solutions to both the malpractice and products liability insurance problems. In the case of the former, the closed claim data gathered and published by the HEW Secretary's Commission on Medical Malpractice was the first effort ever made on a national scale to determine the magnitude of the malpractice problem, and it was nearly four years later before the insurance industry -- with considerable prodding from Capitol Hill -- undertook to supplement the earlier study.[19] In the products area, the insurance industry has yet to produce the first set of data which would substantiate its panic cries for rate increases, and this by its own admission.[20] As of this writing, we still have no authoritative, comprehensive nationwide figures showing claims frequency and severity, average claim costs, average allocated claims expense, or relative profitability of the products liability line. It is anticipated, however, that some claim data currently being gathered by the Insurance Services Office and by several of the contractors doing studies for the Interagency Task Force will provide useful baseline information in the near future.

Without question, there is much similarity in the way that people talk about the medical malpractice and products

liability problems, particularly with respect to such matters as the role of the tort system and the influence of legal doctrines on the initiation or outcome of the decided cases. The thrust of most of this talk is that legal doctrines which at one time were considered fair to all parties have gradually been eroded by the courts to the point where plaintiffs now have the decided edge over defendants in tort litigation. As is usually the case with sweeping generalizations, these charges do contain a certain degree of validity. Legal doctrines governing personal injury litigation have indeed undergone noticeable judicial revision during the past decade or so, with the bias clearly being in favor of plaintiffs, but a careful reading of the decisions in the leading cases generally reflects an attempt on the part of the courts merely to correct existing inequities in the law tending to favor defendants in tort litigation. There are clear examples of this both in medical malpractice and products liability litigation.

For many years, plaintiffs in medical malpractice cases were confronted with literally insuperable problems of proof of medical negligence, particularly where complex medical procedures were involved. Proving a physician's departure from the normal standard of care required expert testimony which, as plaintiffs only too frequently learned, was virtually impossible to arrange. Inevitably, the courts took notice of the injustice

resulting from the inability of injured claimants to procure medical experts,[21] and they took appropriate steps to correct the situation by judicial acceptance of less stringent requirements for proving fault. Thus, a variety of legal rules gradually became more prominent in malpractice cases, e.g. res ipsa loquitur, the common knowledge doctrine, the use of textbook authority, the rule permitting a plaintiff to use the defendant physician as an expert witness, abrogation of the locality rule, etc.

In addition to the foregoing, other substantive doctrines applied with increasing frequency in malpractice litigation have tended to correct some of the inequities faced by claimants seeking recoveries for their medically-caused injuries, e.g. informed consent and the discovery rule. Needless to say, the plaintiffs' bar applauds these liberalizing changes in tort law with as much vigor as the defense bar condemns them. The Secretary's Commission on Medical Malpractice debated the pros and cons of these changes at length and concluded, by and large, that they have not been as vital to the disposition of medical malpractice cases as often contended, and in any event, have not been applied uniformly by the courts in all states. In the final analysis, the Commission concluded that the public interest requires only that such doctrines be applied fairly and with some degree of uniformity.[22]

Products liability law likewise has undergone significant

change in the past decade, with the doctrine of strict liability having assumed major importance in this field of litigation. Privity of contract has disappeared as a requirement for an injured claimant to prevail, and though liability based on negligence has survived to some extent, it is now treated more as a secondary line of attack to supplement the principal theory of strict liability.[23]

As in the case of malpractice law, extension or modification of traditional legal doctrines was prompted in part by judicial recognition of the enormous difficulties of proof faced by injured claimants. As noted by one legal scholar.

> "The change from negligence to strict liability meant that it was no longer necessary to prove negligence on the part of the defendant. * * * It is often difficult, or even impossible, to prove negligence on the part of the manufacturer or supplier. * * *[24]

But behind many of the recent decisions endorsing the strict liability concept lurks another legal rationale, namely, that as between an innocent victim of a product's propensity to create harm and the (presumably) insured manufacturer of such product, the latter is in a better position to spread the risk of loss which occurs and that the loss should not be allowed to remain with the injured party on whom it fortuitously fell.[25] There

is little doubt that this view of the law is in direct conflict with the underlying fault basis of the tort liability system operative in this country since 1850, namely, that some innocent victims will have to bear their own injury losses.[26]

Obviously, something significant is taking place in our legal system to encourage the shifting of losses from innocent victims to those whose enterprises are likely to result in actionable harms, and all the legal pressures appear to be in the direction of broadening rather than limiting the liability of those engaged in such enterprises. We see growing evidence of this trend both in products liability and medical malpractice appellate decisions. Thus, in the landmark products case of Greenman v. Yuba Power Products, Inc., 377 P. 2d 897 (Cal. 1962), the court noted:

> "The purpose of such [strict] liability is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than the injured persons who are powerless to protect themselves."

In the 1967 case of Clark v. Gibbons, 426 P. 2d 525, the California Supreme Court held the defendant liable under res ipsa loquitur for injuries to the plaintiff resulting from an inexplicable operating room accident. Justice Tobriner, who concurred in the majority opinion but strongly disagreed with its reasoning,

advocated absolute liability in such inexplicable accident situations, without resort to the "largely fictitious and often futile search for fault which characterizes medical injury litigation." In an unusual display of candor he urged as a matter of public policy that the losses of otherwise unexplainable medical accidents "be shifted to the parties best able to protect against them through insurance * * *."[27]

For better or worse, decisions of this nature --- which are becoming increasingly common in personal injury litigation --- reflect society's apparent desire to shift the focus from the defendant's conduct to the victim's plight, and judicial commentary in this respect is increasingly evident. There is little doubt that both the malpractice and products liability problems have served to direct greater attention to the generic problem of injury reparations, a problem which has its interfaces with all categories of personal injury litigation, with benefit levels in workers' compensation and disability benefit programs, and with the matter of compensation of victims of criminal assaults, compensation of injured human research subjects, and the like.[28]

It is noteworthy that one of the principal studies conducted by the HEW Malpractice Commission focused on the problem of iatrogenic injury, that is, injury arising out of the treatment process itself. The study showed that 7.6% of the patients treated in hospitals for medical/surgical problems other than normal deliveries suffered varying degrees of iatrogenic injury. Extrapolating to the 35 million hospital admissions annually, the number of iatrogenic injuries nationally totals approximately 2.6 million, a figure which

does not include iatrogenic injuries incurred in physicians' offices or hospital outpatient departments. Since we know that not more than 20,000 - 25,000 malpractice claims a year are being filed at the present time, it is clear that the vast majority of injured persons are absorbing the economic losses associated with their injuries, either in whole or in part.

The Malpractice Commission gave considerable attention to the plight of these individuals and, in particular, their needs for prompt restorative treatment and compensation of their out-of-pocket economic losses. One of the Commission's major recommendations was that a major governmental effort be initiated to explore alternative compensation mechanisms to achieve the above objectives. No such effort was undertaken by the Government, however, although the malpractice crisis which flared up in 1975 undoubtedly revived interest in this problem. Significantly, the swine flu claims legislation enacted in August of 1976 (P.L. 94-380), mandates an HEW study of "alternative approaches to providing protection against such (immunization program) liability . . . including a compensation system for such injuries. . . "

Thus far, comparatively little discussion has centered on the needs of persons injured by defective products, with most of the concern to date being devoted to the insurance problems of products manufacturers. Certainly no organized consumer lobby has actively entered the debate on this critical issue ----- these interests apparently spending most of their time and energies

in opposing attacks on the tort system perceived to be inimical to the interests of personal injury litigants in general. It is somewhat of a mystery why the consumer interests have chosen this tack, since individual litigants at least have legal representation in contrast to the vast numbers of injured persons (both in the malpractice and products environments) who either are uninformed of their legal rights or, for other reasons, choose to forego efforts to recover damages under the present adversary system.

Few would argue that products liability law is far more diverse than malpractice law, encompassing a variety of legal issues and doctrines entirely foreign to malpractice litigation. The obvious distinction is the difference between a product and a service, with products law focusing on such matters as what constitutes a defective product, state-of-the-art and product misuse defenses, applicability of comparative fault, what constitutes an "unreasonably dangerous" product, the role of warnings to consumers, and extensive concern with application of the statute of limitations to products which may have been manufactured many years ago. Compounding the usual problems in personal injury litigation is the fact that products manufactured in one state commonly are distributed nationwide, bringing into play procedural law problems of conflicts of laws and applicability of state long-arm statutes.

One of the most vexing issues in products law is the matter of suits for injuries arising out of defects in capital equipment brought by employees of comanufacturers or final-product assemblers.

Under the workers' compensation laws of nearly all the states, an injured employee is limited to recovery of workers' compensation benefits in a claim against his employer, but he is not precluded from directly suing the original equipment manufacturer for negligence in product design or manufacture and recovering damages in full. A defendant manufacturer's ability to apportion such loss by bringing a third-party claim against a concurrently-negligent employer of the plaintiff is by no means clear, with considerable differences in legal treatment from state to state on the right to contribution or indemnity, the effect of hold harmless clauses, and the right of subrogation in general. Thus, the whole subject of product-related workplace injuries to employees is fraught with legal complexities which simply have no analogue in malpractice law. Parenthetically, it is in large part due to these complexities that products liability litigation is undoubtedly more costly than malpractice litigation, a fact that should give pause for reflection to those who view the tort liability/insurance indemnity system as a vehicle for compensating injured persons with some semblance of efficiency.

To the extent that the malpractice and products liability problems share corresponding legal system concomitants, their greatest identity of interest probably lies in the rules regarding ~~the~~ damages. The subjects most often cited by those seeking to bring about change include: (a) regulation of attorneys' fees, (b) regulation of awards for pain and suffering, (c) modification of the collateral source rule, (d) use of structured awards which

call for periodic payments rather than lump-sum awards, (e) restriction or elimination of punitive damages, (f) placing maximum limitations on awards, and the like. Each of the foregoing has been the subject of legislative enactment in one form or another by states grappling with the malpractice problem, and it is not unreasonable to assume that similar legislative lobbying efforts soon will be undertaken by those seeking products liability reforms.

The latter point raises an important question about the fundamental relationship between liability-insurance and tort process, an issue whose implications are often overlooked. Those who urge "tort reform" in the malpractice and products liability areas take for granted that the goals of tort law and liability insurance necessarily correspond, when it is more likely that the two represent what one scholar has called a "miscegenetic union" of conflicting interests that rarely serve the broader goals of society.[29] To illustrate: a commonly assumed goal of tort law -- just compensation for harm -- is squarely in conflict with a fundamental goal of the liability insurance system, which is to make higher profits by keeping losses as low as possible.

Those who criticize the inefficiency of the tort system by pointing out how small a percentage of policyholders' premium dollars inure to the benefit of injured claimants simply ignore the realities of the situation: liability insurance is a device whose prime function is to protect the assets of policyholders (and their insurers) and achieving this result requires <u>avoiding</u> payment of compensation, if at all possible. This objective is totally inconsistent with a system whose function is to serve a broader public goal, e.g., to provide prompt, equitable, and

adequate compensation to injured claimants. The failure on the part of those in positions of authority to comprehend the serious infirmities of the tort process/liability insurance nexus has severely hampered efforts to solve both the malpractice and the products liability problems. For reasons of self-interest, the insurance industry goes to great lengths to preserve the essential status quo of the present claims system while simultaneously urging major tort reforms. By equating "tort reform" with "protecting the public interest" --- as casualty insurers have urged upon legislators seeking solutions to the malpractice problem---artifice has be elevated to new heights, since the reforms being sought invariably limit or suspend long-established rights of injured claimants while legitimizing new immunities or privileges for doctors and hospitals not accorded defendants in other types of personal injury litigation.[30] We must not forget, however, that the insurance industry is a profit-motivated enterprise whose interests are not, and never have been, oriented toward serving broad, public goals. No better example of this could be cited than the conflicting interests of the Federal Government and the insurance industry during the recent swine flu insurance imbroglio.

Despite the dysfunctional nature of the system noted above, there is little likehood that any radical change in perspective will occur in the immediate future. Accordingly, we can expect a plethora of state-level task forces and advisory commissions to study the products liability problem similar to those created to deal with medical malpractice. And if history is any guide,

we may also expect the reports of these state advisory bodies to parrot one another ad nausem, repeating the same litany of facts and myths as though the problem was somehow unique to a particular state. Most of these reports will be replete with testimony taken at state insurance department or other public hearings, where industry witnesses seek to outperform each other in detailing the disastrous consequences of the products liability problem on their particular businesses or segment of the industry.[31] Hearings have already been held in Washington by the Small Business Subcommittee of the United States Senate.

Insurance reforms understandably have received great attention in the malpractice and products liability areas, attesting to the essential similarity of the underlying insurance problems --- cost and availability. Of the vast variety of state legislative reforms enacted this past year to cope with the malpractice insurance crisis, many have dealt with the subject of insurance availability. Statutory joint underwriting associations (JUA's) abound, and many are serving a vital function in offering what amounts to the only source of malpractice insurance for health providers in certain areas of the country. Clearly, similar JUA approaches will be suggested in the products area as well, although we can expect greater resistance to their creation for several reasons. For one, availability is not as great a problem with respect to products insurance as is the matter of cost and affordability. But of even greater significance is the fact that a products liability JUA, unlike its malpractice counterpart, would subject insurers in the state in question to financial

burdens attributable to products manufactured outside the state [by virtue of state long-arm statutes] a situation which raises serious problems with respect to ratemaking and loss prevention, and cannot help but encourage forum-shopping. Resolving the availability problem in products liability, therefore, compels consideration of insurance remedies other than state JUA's to circumvent these undesirable results.

Another insurance problem affecting both the malpractice and products liability lines is the actuarial uncertainty relating to claims frequency and severity. In attempting to make reasonably accurate projections of future claims frequency and severity, the actuary must take many "unknowns" into consideration, including changes in the legal and social environment, economic conditions in the economy as a whole, and the increasingly adverse effects of inflation on payouts and loss adjustment expenses. As the sad experience of the recent past has shown, the actuary cannot assume that conditions which exist during any given base period will remain stable and, therefore, can be relied upon in making rates for the ensuing policy period.

Complicating the ratemaking process is the long-tail nature of these claims, a matter which affects both the malpractice and products liability coverages, though in slightly different ways. Shortening the tail in order to improve predictability of claim frequency and severity trends is the desired goal, but how best to achieve that result is a major problem. In the malpractice area, the effort has focused mainly on changes in statutes of limitations and on switching from the occurrence form of policy to the claims-made form, with considerable impetus to the latter

approach coming from the nation's largest malpractice carrier, which now uses the claims-made form exclusively in its writings.

In the products area, claims-made policies have long been the norm, but the long-tail problem is equally significant in that claims filed during the policy period can (and often do) relate to allegedly defective products manufactured years and even decades earlier. Changes in statutes of limitations may have an ameliorating effect on the long-tail problem in both the products and malpractice lines, but the issue is decidedly more complex with respect to product liability claims. This is due to the fact that products liability claims often involve multi-state litigants, creating difficult conflicts of laws problems on the applicable substantive rights and remedies of the parties. The interstate nature of most products liability claims, therefore, makes resolution of the long-tail issue (and consequent actuarial problems) far more intractable and less amenable to solution on a state-by-state basis.

Overemphasis on the insurance aspects of both the products liability problem and the medical malpractice problem has masked underlying factors deserving of greater attention. Rising claim frequency, for example, is not AN insurance-caused phenomenon, nor is claim severity, though both have a close relationship with the way the insurance system functions. Without question, public awareness of liability insurance coverage on the part of health care providers and products manufacturers has, to some extent, stimulated suits for injuries sustained as a result of improper health care treatment or product defects. But injury itself is the essential

prerequisite for bringing such an action --- a fact often overlooked by those striving to cope with the "insurance problem" of rising-claim frequency. Similarly, public awareness of liability insurance coverage undoubtedly has resulted in higher awards in some litigated cases and a greater willingness to find liability in others; but these factors merely reflect the infirmities of linking the tort process with liability insurance noted earlier, a systemic problem which can hardly be corrected by tinkering with the insurance mechanism alone.

When one analyzes attitudes towards the potential Federal role in dealing with the malpractice and products liability problems, one cannot help but be struck by the differences in enthusiasm for Federal involvement. Although the problems of malpractice insurance (and to a lesser extent availability) have been a source of concern to the medical profession for a great many years, no one in organized medicine looked to the Federal Government for any sort of help during the malpractice crises in the late 60's and early 70's. Despite the increasingly negative impact of rising malpractice insurance costs both on individual physicians and on the health care delivery system as a whole, the American Medical Association was able to state in 1969 that the only role of the Federal Government should be "to encourage appropriate action by the state governments."[32] Significantly, the First National Conference on Medical Malpractice, convened in Chicago in February of 1970, was co-sponsored by the Department of Health, Education, and Welfare and the American Osteopathic Association, with the American Medical Association declining an invitation to co-sponsor the event.

The idea to establish a national commission to explore the medical malpractice phenomenon emanated entirely from within

the executive branch of government. It was one of a series of health options submitted by the Secretary of HEW to the White House in late 1970, leading to creation of the 21-member study commission in mid-1971. Following the issuance of the Malpractice Commission's report in early 1973, interest in the subject waned --- partly because the country was not then experiencing any serious availability problems and partly because organized medicine was decidedly unhappy with the report itself. Regardless of the reason, from that day to this, with only an occasional departure from its position,[33] the medical profession has studiously avoided any request for Federal assistance or legislation to deal with this still-unresolved issue.[34]

While it would be a gross overstatement to assert that the business and manufacturing interests most affected by the products liability insurance crisis have enthusiastically urged Federal involvement, their willingness to solicit some form of assistance at the Federal level is evidenced by their plea for help to the Economic Policy Board early in 1976, which led to the 30-day study by the Commerce Department and, in turn, the establishment of the Interagency Task Force on Products Liability. The interstate nature of products distribution certainly suggests the need for broader national solutions than called for in dealing with the malpractice crisis, though the precise nature of those solutions has yet to be agreed upon by anyone.

In conclusion, it would be fair to say that the medical malpractice and products liability problems share a number of common elements, the most notable of which relate to insurance concomitants. Thus, the insurance market has become rather severely

constricted with respect to both the malpractice and products liability lines, with policyholders in both categories facing highly selective underwriting practices, enormous rate increases and, in some instances, no available coverage --- at least not at affordable rates.

In the malpractice area, a variety of insurance alternatives have evolved, including: (a) formation of physician-owned carriers, (b) formation of captive insurers, (c) statutory joint underwriting associations, (d) greater resort to self-insurance by hospitals, and (e) total abandonment of insurance coverage by growing numbers of physicians -- probably as many as 15% of the physicians in practice. What form of insurance remedies will emerge in the products area is difficult to predict, but the interstate nature of products distribution suggests insurance solutions which are decidedly more national in scope.

To the extent that we are witnessing a general rise in all forms of personal injury litigation in this country, malpractice and products liability claims have been a part of this phenomenon and are likely to contribute to rising claim frequency for some time to come. Note, however, that despite all the hue and cry about a so-called "malpractice crisis," we are still seeing far fewer malpractice claims than the medical injury statistics would seem to warrant. One of the reasons for this may be the somewhat unique nature of malpractice litigation, in that a malpractice claim often represents the final breakdown of a personal relationship between two parties -- physician and patient -- a breakdown not infrequently fueled by emotional and psycho-social

factors which simply have no counterpart in products litigation. With the stimulus of a variety of consumer-oriented Federal statutes relating to the manufacturing process, it is not unreasonable to conclude that products claims will continue to increase at an accelerating pace throughout the foreseeable future.

The fault-oriented liability insurance mechanism is already under severe stress, and its future is in considerable doubt. The legal environment --- perhaps because of a mistaken conception of the role of liability insurance--- has veered inexorably toward the socialization of injury,[35] a concept totally at odds with the liability insurance mechanism. Thus, the battle to preserve the present system, albeit with change, may prove to be of no avail if the public increasingly perceives liability insurance as a <u>compensation</u> mechanism, rather than the <u>indemnification</u> mechanism it was intended to be.[36] Policymakers seeking solutions to both the malpractice and products liability problems may well find it more desirable to focus on a comprehensive injury reparations approach if their objective is to achieve social goals not compatible with the liability insurance system as presently structured.

* * * * *

Footnotes and References

1. Sadusk, J.F., "Malpractice Litigation--The California Experience," 27 Conn. Medicine 620 (October 1963).

2. Silverman, M., "Medicine's Legal Nightmare," Saturday Evening Post, April 11, 1959. 15.

3. From time to time, critical insurance problems have surfaced in a number of states.- For example: California in 1953, 1968, and 1972; Alabama, Pennsylvania, and Hawaii in 1970; Florida in 1959 and 1974.

4. Jones, T.L., "AIA: Crisis Brewing in Product Liability," National Underwriter, October 3, 1975, 1.

5. Kalmykow, A., Assistant General Counsel, AIA, in a letter to S. Sherwin, Deputy Assistant Secretary for Commerce, February 25, 1976.

6. "Inflation in Product Liability," Business Week, May 31, 1976, 60; "Who Pays?," Forbes, August 1, 1976, 57.

7. The Senate Select Small Business Committee has already begun hearings (September 8, 1976), and several bills have been introduced in the Congress to deal with the product liability crisis.

8. See "Product Liability Insurance--Assessment of Related Problems and Issues," U.S. Department of Commerce (March 1976) at 5; Du Bain, "The Next American Revolution," Vital Speeches, February 15, 1976, 276.

9. See editorial, "Sue the Bastards: A Social Malaise," Business Insurance, August 9, 1976, 24.

10. P.L. 92-542, 86 Stat. 1108 (October 25, 1972).

11. P.L. 92-516, §3(1), 86 Stat. 998 (October 21, 1972).

12. P.L. 92-516, §3(2), 86 Stat. 998 (October 21, 1972).

13. P.L. 93-237, §2(C), 87 Stat. 1024 (January 2, 1974).

14. P.L. 92-573, 86 Stat. 1207 (October 27, 1972).

15. Jaffe, A., "A Coming Crisis in General Liability Insurance?," National Underwriter, August 15, 1975, 21.

16. Heap, I.R., "The Liability Explosion," Journal of Insurance, July-August 1975, 10.

17. "California Job Action Likely to Abate soon," American Medical News, February 9, 1976, 1; "California Legislators Debate Liability Crisis," American Medical News, May 26, 1975, 12.

18. See Report of the Special Advisory Panel on Medical Malpractice (State of New York), January 1976, 106-108.

19. See hearings before the Senate Subcommittee on Health, April 9, 10, 15, and 18, 1976; in particular, testimony of Secretary of HEW Casper Weinberger at 324-326.

20. Statement of American Mutual Insurance Alliance to the NAIC Task Force on Product Liability, August 5, 1976.

21. Salgo v. Leland Stanford Board of Trustees, 154 Cal. App. 2d 560, 568, 319 P. 2d 170, 175 (1957); Richison v. Nunn, 340 P. 2d 793, 802 (Wash. 1959); Clark v. Gibbons, 66 Cal. 2d 399, 426 P. 2d 525 (1967) (dissent of Justice Tobriner).

22. Report of the (HEW) Secretary's Commission on Medical Malpractice, U.S. Government Printing Office, Washington, DC, January 16, 1973, 31.

23. Wade, J.W., "On the Nature of Strict Tort Liability for Products," Insurance Law Journal, (March 1974), 141.

24. Id. at 141-2.

25. Id. at 142.

26. Franklin, M.A., "Replacing the Negligence Lottery: Compensation and Selective Reimbursement, 53 Va. L.R. 774, 779 (1967).

27. 66 Cal. 2d 399, 426 P. 2d 525, 538 (1967).

28. The New Zealand experience in dealing with injury reparations under a comprehensive national scheme may well serve as a stimulus to the development of similar theoretical approaches in the United States. See Sandford, K.L., "Comprehensive No-fault: The New Zealand Experience," address to the IAIABS, New Orleans, September 22, 1976.

29. Smith, A.E., "The Miscegenetic Union of Liability Insurance and Tort Process in the Personal Injury Claims System,"54 Cornell L.R. 645 (1969).

30. Starr, P., "The Doctors' Discomfort," New Republic, June 28, 1975, 21.

31. "Witnesses Tell of Business Liability Woes," Business Insurance, September 30, 1976, at 1, 59, 60.

32. See response of Richard Bergen, AMA Legal Research Director, to the Senate Subcommittee on Executive Reorganization in "Medical Malpractice: The Patient versus the Physician," Committee Print, November 20, 1969, at 509.

33. See "AMA Backs Federal Law on Liability," American Medical News, December 23, 1974, 1.

34. See testimony of Malcolm Todd, M.D., President of the AMA, at the malpractice hearings before the Senate Subcommittee on Health, April 9, 1975, 169-188.

35. Vanderwicken, P., "Toward the Socialization of Injury," Fortune, November 1971, 161.

36. See Note 29 and accompanying text.

* * * * *

Part IV: The Consumer Perspective

The Task Force was very interested in ascertaining the consumer perspective about the nature of and solutions to product liability problems. As the Final Report indicates, this was essential if the Task Force's study was to be both objective and balanced.

The Task Force identified three principal concerns of the consumer in regard to the product liability problem. First, the product liability problem can cause (and apparently has caused) an irrational increase in the price of some products. Second, some of the proposed solutions to the product liability problem may deprive consumers of the opportunity to obtain reasonable compensation for injuries received from unsafe products. Consumers have an interest in preventing the implementation of such solutions. Finally, consumers have an interest in ensuring that manufacturers have incentives to produce safe products.

Because of the importance of the consumer perspective in achieving a balanced and objective solution to product liability problems, it seemed appropriate to include three statements which articulate that perspective and which were frequently cited in the Final Report. The first was presented

by Ms. Anita Johnson, then of the Health Research Group of Public Citizen, Inc., at the fourth meeting of the Advisory Committee to the Under Secretary of Commerce (June 27, 1977). The other two statements were delivered by Mr. Ralph Nader, President of Public Citizen, Inc., and Ms. Benedicte Federspiel, Director of the Legal and Economic Division of the Danish Consumer Council, at the First World Conference on Product Liability in London, England on January 21, 1977.*/

The Task Force wishes to acknowledge the cooperation of The Research Group International for granting the Department of Commerce permission to reproduce the statements made at that conference.

---

*/ That conference was sponsored by The Research Group International. For further information concerning the Proceedings to the First World Congress on Product Liability, one should contact The Research Group International, P.O. Box 7187, Charlottesville, Virginia 22906 (804-977-5690).

MS. JOHNSON: I am employed by a consumer organization. I just have a couple of casual observations. I didn't come prepared to make a statement.

I heard virtually no attention this morning to the subject of lowering the cost of fact-finding. One of the reasons you're all complaining is that it is very expensive to determine what the facts of an injury are and it is very expensive to determine whose fault it is.

I would think a major priority of you all would be how can we spend less money determining the facts of the case and determining the fault involved.

Second, this morning at least, I have heard very little about the prevention of injury. What new measures do you all suggest for preventing the injuries that you are now complaining about?

In the small business hearings a manufacturer of trampolines from Iowa complained bitterly about the unfair arbitrary costs of products liability insurance in his business. It turned out the man was selling trampolines to high schools. Although I do not know the man's business, I would venture to say that it is virtually impossible to adequately supervise the use of trampolines in a high school setting. Yet no one on that Committee questioned him about whether he was, in fact, selling a rather dangerous product in a rather dangerous situation and that if he took those kinds of risks, it was essentially his tough luck. I might add the tough luck of a number of multiplegics that resulted from use of his products.

I have found this morning at least, relatively little attention on your part to alternative insurance mechanisms. The representative of Congressman Whalen has suggested a very conservative, sensible idea. I think, in general, we all have a relatively limited understanding of the relative functions of insurance companies.

On the one hand, insurance companies make money by investing in the stock market and other places, and on the other hand, insure companies by selling insurance. There is a close relationship between the health of investments of the individual companies and the amount of money that they are charging for insurance. It may well be, and certainly there is

testimony in several Senate hearings on the subject, that as insurance companies lose money in a bad stock market that they have to make up for losses elsewhere.

I am not saying that is true, but I am saying that the fact that the cost of insurance is rising does not mean that products liability doctrines are crazy, unfair or bizarre to businessmen. The cost of insurance is rising means only one thing on its face and that is that the cost of insurance is rising.

You all need to be more skeptical, in my view, at least about what reasons there are in the conduct of insurance raising these costs. And to what extent can self-insurance, for example, why are trade associations not more active in promulgating products liability insurance plans for their members?

One of the advantages I think certainly true in the malpractice area, one of the advantages of these self-insurance programs is that it provides much closer control over the prevention activities of the individual manufacturers.

I find that some of the remedies you all sort of take as an article of faith are very extreme. The automatic cutoff has already been commented on by Mr. Rheingold and I agree with his views.

The state of the art defense I find the most to my mind, well, vying for the two most obnoxious proposals, the

real effect of the state of the art defense, that is, the absolute defense that industry custom, following industry custom is a total defense to a consumer industry means that industry determines its own safety obligations under the law.

I can see why as businessmen, it is your role to promote your own powers. I can see why as business you would want to supplant the court function of determining legal obligations. But I think society as a whole would not accept the proposition that industry should determine its own obligations. The -- and I certainly don't accept it.

I oppose it very strongly. I think that if the state of the art defense succeeds in states such as Ohio, that the overall level of marketplace safety would go down a great deal. Moreover, that industry custom would go down a great deal because there simply would be no challenge to industry custom.

You all could be 30 years behind the times in terms of safety devices, in terms of chemical toxicity, et cetra, and it wouldn't matter as long as you all were equally behind the times. In fact, it would give you all a very great incentive to make sure that none of your members got out in front of the pack.

It is sort of very similar to, well, sociological studies that you hear about of line workers who work in groups on the highway stringing, this is elementary sociology.

Excuse me if I am sounding very silly, Mr. Harman, but I remember from college reading studies of working groups, telephone linemen going out on the highway and a new member comes into the group and frantically works to string more line and very quickly within a number of days the other call him aside and say listen buddy, if you want to get along around here, you better slow up your work and sure enough, in a couple of days, the new man is just as slow stringing line as the others are.

I think that that is exactly the kind of group dynamics that would be created if the state of the art defense was enacted as a absolute defense. I sort of have to chuckle at this idea that compliance with government regulation should be an absolute defense. I have often heard that American business is full of dynamic, energetic fighters looking for new challenges, waiting to innovate. And the compliance with government standards is sort of the idea, well, you know, I shouldn't be liable because the government didn't tell me I couldn't do this. It is the sort of making plastic men out of American businessmen essentially.

Let's all sit back and as long as we do the minimum that the government tells us, that is, if FDA approved my drug, I have no particular reason to improve the safety of it because I am covered. And sure I knew DES causes cancer; sure I knew in 1960 that DES was not valuable for prevention spontaneous

abortion, but FDA approved my drug. I met government standards. All I had to do is do what FDA told me to do and that's all.

I think that is a pretty unfavorable and and I hope untrue picture of American business. I think that the common law has been a very valuable institution to the growth of our society and to the growth of English society as well. The great value of common law as opposed to statutory law, as you all know from freshmen torts, is its ability to judge the merits and facts of each individual case on its own.

The common law has grown with the increasing ability of our technology to assess its risks as well as its benefits, and I have a great fear as a general principle, a great fear of making personal injury law a matter of statutes rather than a matter of judge-made law.

I think we all agree that there has been a large number of -- well, the number of complaints filed by injured consumers in recent years has definitely increased; think we all agree to that amount and you all see to be opposed to that.

I don't think it is so bad. First of all, all law-suits are increasing greatly. In years gone by in landlord-tenant disputes, a tenant just did what the landlord said. It never occurred to a tenant that he might have a legal right to stay in his building, et cetera.

Landlord-tenant disputes did not go to litigation.

In years gone by, a person who was injured by DES or a person injured by a -- press machinery without adequate safeguards would just consider the injury to be fate, an act of God. Certainly on DES, again, I think at one time we all thought cancer was just an act of God. We now know that cancer is caused by chemicals, much of it, 95 percent of it perhaps.

The amount of litigation generally is increasing at about the same rate as product liability litigation from what I read in these reports. Products liability litigation remains a tiny fraction of the litigation we are seeing. In some ways increased litigation is healthy as I think, because it recognizes new consumer rights, but also because isn't that what our court system is for?

Our court system is for deciding disputes between different members of society. Isn't it nice that consumers are recognizing that they might have rights that would be recognized by the court system? Isn't it nice that consumers are not saying, gee, it was just my fate that I was given DES by my doctor in 1960? Isn't it nice the consumer is saying, gee, isn't it funny that I was prescribed the Dalkon Shield as opposed to some other contraceptive device? Isn't it nice that people are going into the courtroom instead of shooting each other, and obviously that is the one great advantage of the court system.

So I would say in summary of this last point, that

increasing court cases is not necessarily a bad thing. What our task in the future is to do is to decrease the costs of this litigation and make this litigation available for middle size and small injuries as well as large injuries.

Thank you.

PRODUCT LIABILITY AND THE INJURED PARTY: PRODUCT LIABILITY AND THE CONSUMER

Ralph Nader, Esquire

Lawyer and Leading American Consumer Spokesman,
Washington, D.C., U.S.A.

Thank you very much and good morning to all. I can say that with some fervor since it is about 5:00 a.m. in Washington and the inaugural activities have just begun to subside. I am delighted to have the opportunity to speak (by transatlatic telephone) with you this morning on the subject of product liability and the consumer. I understand that Mr. Belli has regaled you with his experience and his vast storehouse of knowledge and that you have seen some of the specific documentation of product defects in Mr. Bloch's presentation. Unfortunately, the events associated with the governmental transition here in Washington precluded my personally being with you, but fortunately communications in this day and age to some degree substitute for transportation.

Our subject today is one that reflects on the cost-benefit of an industrialized age. The mayhem of the machine age has for a long time lagged behind the spirit of the law in providing injured people with the legal tools and the rights of compensation and the consequential deterrence impact pursuant to their recourse in the courts of law. There is an analysis here, known as ergonomics in the United Kingdom and human factors in the United States, an analysis that is very pertinent. Basically, it is one that sees, as one of the purposes of the law, the dissemination of pressure to force the redesign of machines so that they adjust to human deficiencies or human needs rather than place the whole burden on the human operator or user of consumer products to adjust to deficiently constructed or designed machines. This is a traditional function of the common law, which, of course, our country inherited from the United Kingdom, but it is a function that has to be continually refined, continually brought up-to-date and kept attuned to the vast proliferation of products and drugs, to automobiles, to flammable fabrics, to toys, all of which increase the exposure of risk to injury on the part of many, many people.

One of the many problems, of course, is to generate the level of public concern that often translates into new legal rights and remedies, and statistics can serve that function. The casualty toll attributed to defective products and services—I want to emphasize services in this context as well—often are like the tip of the

iceberg. For many years in the United States almost all fatalities and injuries on the highway were attributed to driver misbehavior. More recently, the factor of highway design defect and automobile construction and design defect have been given long overdue recognition. Unlike the tip of the iceberg, the extent to which the law can generate a deterrent impact will result in the iceberg itself getting smaller. The more the tip of the iceberg is exposed to the sunshine effect of product liability law, the more likely will be the greater care exercised by engineers, by lawyers, and by the corporations involved, in determining the safety design and the warning of use in the merchandising of the particular product.

Now, in the United States it is important to make a distinction which perhaps you will find useful in your understanding of the emerging situation in Europe, a distinction between regulation for safer products and accountability for unsafe products. Traditionally, the approach in the United States has been a back and forth relationship between litigation in products liability and the establishment of government agencies which are supposed to issue standards of safety for manufacturers to observe.

The approach in the United States has been a kind of interrelationship between government regulation in the area of product safety and an accountability pattern which goes by the name of products liability. Now it is important to note that these have nourished one another. For example, over ten years ago, Senator Gaylord Nelson launched the movement in the Congress for the Tire Safety Act by taking information from a San Francisco case involving a products liability suit against a major tire manufacturer which involved internal documents by that manufacturer showing the paucity of tests and the lack of adequate standards in the design and marketing of that particular kind of tire. That information was put forward on the Senate floor during the gestation of this legislation and played a key role in the passage of the Tire Safety Act of 1966.

By the same token, regulation leads to the issuance of standards after proceedings where evidence is adduced. This evidence is often obtained by lawyers who then use them in cases involving manufacturers of allegedly defective products. This kind of interrelationship not only complements a broader advance in product safety and a respect for human rights of health and safety but also develops something quite significant for the future. And that is that you can always fulfill an individualized justice goal with product liability that regulation and its standards by a government agency can never fill. We all know that political influence often distorts a regulatory agency's purpose in either not issuing standards on time or in diluting these standards. On the other hand, there is always the standby safeguard in courts all over the country on behalf of

injured plaintiffs. So that the regulatory approach generates a preventive general standard function, and the products liability approach deals with individualized justice on a case-by-case basis.

This, of course, raises an issue which I think will trouble people in Europe as well as in the United States. That is, to what extent will government safety standards either preclude or limit the range of recovery in products liability cases? To what extent will defendant manufacturers be able to say that they met a U.S. Government auto safety standard and therefore plaintiff has no case in bringing the matter before the court on an alleged auto design defect? In the United States auto safety law, there is a specific provision which says that adherence to federal standards by auto manufacturers will not constitute a defense in common law. In other words, the Congress wanted to leave the door to the courtroom open for products liability in the auto area. Such legislative drafting clarity, however, does not prevail in many other federal safety standards, for there is a constant ambiguity as to the effect of introducing at trial the existence and adherence to federal, or even state, standards.

The problem is further complicated by a frequent tendency on the part of state and federal government agencies in the U.S. to adopt the standards of industry technical organizations, such as the American Society of Mechnical Engineers or the Society of Automotive Engineers. These standards are written, in effect, by technical employees of the auto industry or the pipeline industry or whatever the case may be. They are adopted virtually without dissent by the technical association once the subcommittee reports, and then they are often adopted by the federal or the state agency.

The standards problem, whatever way it is resolved, will not disappear and needs to be given very, very close scrutiny so that the regulatory operation of product safety does not unnecessarily intrude and make rigid the products liability flexibility that is so important to maintain.

A next point I would like to make is in the area of product liability as compensation—compensation for injuries and property damage due to defective products or services. The Common Market Directive, of course, comes down very clearly for strict liability. The movement toward strict liability has been gaining headway in the United States over the last few years as well. Strict liability sounds like it eases very substantially the burden of proof. I think that is something you may wish to discuss in your proceedings. There is less than meets the eye in the practical impact of strict liability. The point, of course, is that you still have to uphold a burden of proof. It doesn't take it away. The establishment of

what a defect is, is still difficult even though you don't have to establish negligence. And in some complex products, of course, it is excruciatingly difficult, particularly when the products meet industry-wide standards which have some approval via a regulatory agency's adoption of these standards. I am certain that Mr. Belli can elaborate the extent to which strict liability facilitates the burden of proof but does not diminish it very substantially in many cases.

The size of damages under product liability, of course, are becoming more and more controversial in the United States. As I'll note in a moment, the insurance industry wants to limit damages by revising or passing state legislation in that regard.

I don't think the Common Market Directive is a particularly useful idea, in one sense. That is, the deterrent impact of product liability flows to no small extent from the infliction of unanticipated costs on manufacturers. The extent to which costs can be anticipated and budgeted reduces the deterrent value of product liability. It allows the budgeted costs to be socialized or transferred to the consumer without motivating a newly vitalized quality control system. This is, of course, one of the most difficult conclusions at which to arrive because the studies here are not as abundant and specific as we desire. But from our conversations with people in industry, it is clear that it is the unanticipated cost that feeds a deterrent concern in producing safer products.

The exaggerated product liability crisis which is now making headlines in the United States is just that. For a number of years the insurance industry spokesmen would repeat the claim that there are 1,000,000 product liability lawsuits pending in the United States. This claim has never been substantiated; indeed, it has now been repudiated by the insurance industry's own spokesmen. They cannot substantiate it. Unfortunately, there's no particular aggregate data base on which to conclude exactly how many cases there are, but I for one would be very surprised if there were more than 50,000 product liability cases filed in the courts at the present time. The product liability crisis is not a crisis that can be substantiated by an enormous increase in payouts in verdicts and settlements. Indeed, one of the remarkable features of this "manufactured" crisis is that the insurance industry to this day has not produced data on how much money they take in in product liability premiums and how much they are paying out in verdicts and settlements. The only estimate that I have come across would suggest that there are about $350,000,000 in total payments in the year 1973. Even if it's up to $500,000,000 for 1976, that cannot be considered a national compensation crisis by any means, given the size of the economy and the very, very ample premiums that are being absorbed under the product

liability coverage rubric.

You may be interested in obtaining the results of a questionnaire which Senator Jacob Javits of New York has sent to a number of insurance firms, 35 to be exact. He sent a list of 22 very pointed questions on December 8, 1976, to 35 major insurance firms regarding the product liability insurance needs of small manufacturers and distributors. I am sure that if you wrote to Senator Javits at the U.S. Senate, Washington, D.C., he would be pleased to forward the results of that questionnaire. The Department of Commerce has also been gathering data, and although their final report has not come forth due to the change in Administration, there are some interesting studies and reports which you may wish to obtain by writing to the Department of Commerce Task Force on Product Liability.

I'd like to make a few comments on product liability as a deterrent. Of course, lawyers in taking these cases like to highlight the compensation justice of their efforts to injured parties but also the deterrent effect which has led to safer products. Now once again, there are no comprehensive studies in this area to evaluate the extent of the tie, the connection between products liability verdicts and settlements, and the deterrent consequences of these law suits. But there are a substantial number of cases where such a connection can be made validly. For example, in the infamous railroad turntable cases, the railroad turntable had in the early twentieth century a fatal fascination for children. They could set it in revolving motion like a carousel without music. But the machine would not uncommonly slice off the foot of a participating child—as Professor Lambert has described it in some detail. The cases began coming through around the turn of the century, and these cases brought forth evidence showing that a mere one dollar lock, locking the machine when it was not in use, would eliminate this attractive nuisance in terms of the injuries to children. The imposition of liability here in a number of cases resulted, of course, in the correction of that turntable risk of exposure to children.

In medical malpractice cases, successful medical negligence suits have induced hospitals and doctors to introduce such safety procedures as sponge counts, instruments counts, electrical grounding of anesthesia machines, the padding of shoulder bars on operating tables and the avoidance of colorless sterilizing solutions in spinal anesthesia agents. In the case of dangerous railroad crossings, of course, it is well known that the automatic crossing gates tended to be installed after a particular verdict was rendered in a region of the country. The news traveled fast, when the railroad had to pay up $1,000,000 or $2,000,000 in compensatory and punitive damages.

The same is true in cases involving the tipover steam vaporizer. This is a situation where a tipover steam vaporizer tipped over and burned a three-year-old girl. There were several similar accidents before and after. A $150,000 verdict was affirmed. When the manufacturer refused to take its insurer's advice to recall its vaporizer, the company's continued coverage was refused after over 100 claims against it had been filed. Then in a 1972 advertisement for the same manufacturer's vaporizer there is the statement, "Cover lock tops protects against such spillage if accidently tipped; automatic shut-off." This is an example of the connection between verdicts and deterrence.

Of course, there are many other examples dealing in recycling washing machines, earth-moving machines, exploding Drano cans, etc., where there has been some reasonable inference that could be drawn between the liability and the correction.

There are some cases, of course, that illustrate a minimal deterrent impact. The fuel-tank situation, which seems to be finally turning around toward some improvement, continued many years after it was exposed and after there were some significant verdicts and settlements pursuant to fuel-tank rupturing in rather modest rear-end collision situations. However, I suppose counsel for these manufacturers could give you a much better inside story on the extent to which they are able to change the design and persuade the cost analyst to relent to some degree pursuant to the lawyer's advice that there may be many liability claims that result from the continuation of the existing product design.

I'd like to make a few comments on product liability as it relates to legal and expert witnesses and other representation problems. In the United States one of the greatest reasons for the elaboration of product liability law, beyond that of any other country in the world, has been the contingent fee. The contingent fee has been given the curled lip by some members of the legal profession in the United Kingdom, Canada and Australia, but it is in many ways a facilitator of cases that are brought by poor or middle-class plaintiffs who could not possibly afford to pay an attorney up-front, much less to pay the defendant's costs if the case is lost. Whatever way the European countries approach the problem, I don't think they can ignore it. If they don't choose to go the way of the contingent fee, there must be some reserve, some fund, that can be drawn upon to deal with this economic barrier to the courts of law and permit consequent justice that injured people deserve to obtain.

The problem of expert witnesses is serious everywhere, for several reasons; one is that most of the experts work or consult with industries. They are associated with the defense. Secondly,

some of these independent experts are reluctant to offer their talents because they are always looking for business on the other side and they do not want to be stereotyped as being antagonistic to the particular industry for which they would like to provide services. Thirdly, there are some problems in having experts who work for government agencies to be available as witnesses in product liability trials. In the United States, the record is mixed. Some government agencies encourage or permit their specialists to be witnesses in product liability cases and others discourage them. In a recent product liability case involving an auto manufacturer's sharp external protrusion on the car, which injured a motorcycle driver, an expert witness from a government safety agency provided very important material which led to a very substantial verdict in the case. I think that the government should permit their experts to testify, but not to testify in a partisan sense, simply to answer questions that reflect their scientific knowledge and experience.

As Melvin Belli can tell you in such detail, the future of product liability some years ago received a very prominent boost by the loosening of the strictures by the courts in what kind of evidence can be brought into court. The development of demonstrative evidence has been a critical precondition in the expansion of product liability relief for injured people. Just the same way, the more liberal discovery procedures to obtain from manufacturers internal test data, internal caveat memos and other documents, and to bring them out into the light of open court has dramatically facilitated the possibility of recovery, the possibility of trying these cases at least on their merits, without succumbing to an excessive barrier within the adversary system of justice itself.

There is, of course, in the United Kingdom, and possibly some other countries in Europe the problem of government secrecy prohibiting access to government information, such as test data, that could be used in trials. In the United States we have a Freedom of Information Act which is being vigorously used, not only by consumers, but also by companies, as they try to obtain information about meat and poultry inspection reports, food and drug test data, cosmetic hazards, auto safety information and the like. Because of the existence of this effective Freedom of Information Act, which allows a citizen in the United States to take a government agency to court and compel the production of reports or other documents, there is a greater liberality of disclosure in the federal government in Washington than certainly there is in the United Kingdom. Our understanding of the situation in the United Kingdom, based on some scholars who have been working on this problem in England, is that a great deal of safety information is simply not available to the public. I think any product liability reform in the Common Market must face up to the accessibility of injured people to government expert witnesses and govern-

ment documentation.

Let me give you an illustration of the kind of information you can obtain, as well as American citizens can obtain, by asking Washington: The Consumer Product Safety Commission has on systematic file data concerning the frequency of product hazards, the kinds of injuries that are inflicted, right down to brand names. They have what is called a N.E.I.S.S., a NEISS index, which is an acronym, that provides files which are obtainable on a whole host of product hazards, reported to the Consumer Product Safety Commission by several hundred hospital emergency rooms around the United States. You might be interested also in knowing that the Consumer Product Safety Commission puts out what they call fact sheets. Number eighty-five for example, in this series of fact sheets is on trampolines and there is a description of the number of people treated in hospital emergency rooms for injuries associated with trampolines, as well as a list of sources and technical references on trampoline injuries. I would think that such fact sheets would be valuable for lawyers working in the product liability area.

Also, as far as automobiles are concerned, a great deal of information is available at the U.S. Department of Transportation in Washington on automobile defect recall data. About 50,000,000 cars were slated in the last ten years for defect recalls, foreign imports as well as domestically produced cars. And there is a wealth of information that could be available for lawyers litigating particular car model areas.

A slight diversion here: there is a group in London called the Social Audit, or the Public Interest Research Center, which wanted to get some information from the Road Research Laboratory. The Road Research Laboratory refused it, invoking one of the many Official Secrets Acts that make up the cloak of secrecy that surrounds the British government, so the Social Audit people went to Washington, and they asked the U.S. Department of Transportation for information they had received from the Road Research Laboratory, and they obtained this information from the U.S. Department of Transportation under the Freedom of Information Act. They obtained information from Washington about the British Road Research Laboratory which they could not obtain directly from the Laboratory itself. That is not a singular episode. That is something you may want to keep in mind whenever you are obstructed from getting information in one country, to see whether that information is available under a different set of information laws in another country.

I would like to end on a note regarding the developments recently in the so-called product liability crisis in the United States. Whenever there is any modest success in achieving justice for injured

people, one has always to expect a counter attack, whether by the manufacturers or by their insurers. And sure enough, the insurance industry has led a ferocious counter attack against product liability in the United States via a number of strategic methods. First, of course, they widely disseminated phony data about the number of product liability claims in the courts. And secondly, they began arbitrarily increasing the premiums on small manufacturers, leading to cries of alarm by these small manufacturers which were heard in the United States Senate, and which led to a number of hearings by Senators with the small manufacturers being the prime witnesses.

Now these premium increases were not reflective of the loss experience either of the particular company or of the industry. I would like to quote for you a recent article by a researcher for the Conference Board, that is an industry organization in New York. In this article, it was stated, for example, and I quote, "While it is clear that the casualty insurance industry is experiencing substantial losses, it is not equally clear that rises in an insurance premium rates have been based on a particular company or even industry's claim and loss experience. In the recreational vehicle sector, for example, the lawyer for this industry's trade association told the Senate hearing that a survey of their membership had shown no appreciable rise in either the number of claims or damage payments, yet premium costs had soared by several hundred per cent in two years. In other cases, manufacturers report that although they have never had a product liability claim, let alone a damages payment, they have lost their insurance or face staggering increases in premium costs."

Notwithstanding, the insurance industry has generated pressure in a number of state legislatures to restrict severely both the rules of liability and the way damages are measured. They want to shorten the statutes of limitations; they want to eliminate damages for pain and suffering; they want to control plaintiffs' attorneys' fees, keeping silent about defendant attorneys' fees; and in a number of other areas roll back the years of progress that have signalled one of the bright chapters in the consumer movement in the U.S. It is clear that both consumer groups and trial lawyers have their work cut out for them in the coming legislative sessions.

It is also clear that if the insurance industry does not provide, does not make available insurance for small businesses, that the government in Washington will supply this insurance. This has been done in other areas, such as flood insurance. There is no reason to expect that it will not be done in the area of product liability. Already I am informed by a number of Senators that they are drafting legislation to provide product liability insurance by the Small Business Administration for small manufacturers.

In Europe there is a problem that is not as serious in the United States, and it is the problem of product libel. If the legal profession in Europe is going to be educated in the technical processes of presenting product liability cases, there will have to be a number of public gatherings where lawyers can learn these skills. This is what occurred in the United States, of course, Melvin Belli being one of the teachers of many other younger lawyers in this area. Now this type of education seminar is simply not going to be able to pursue the full free speech rights if manufacturers try to threaten censorship, or, in the alternative, suggest that there may be libel suits brought against speakers or symposiums who dare to mention particular product names. I understand this problem has arisen today involving certain automobile manufacturers. It is quite clear that the requirements of free speech must override any stifling of critical treatment of products by brand name. This is a problem which does not really prevail in the United States. I don't think there is a case of product libel which has been successful in the United States. It is very difficult to libel any public figures in the United States, much less a vehicle, a particular automobile, or a particular drug by brand name. But it does seem to be a problem in some countries in Europe, and it has to be considered even though it is a pre-litigative issue because it relates to how fast knowledge about product defects is going to be disseminated and diffused throughout the legal profession.

In conclusion, I think it important to keep the broader picture in mind. I think that the pressure from consumers via product liability can generate a whole new profession of quality control, a whole new set of rigorous standards, a process whereby defects are foreseen and forestalled, a humanizing of technology. Indeed, to that extent, there will be an increasing deterrence in order to bring to bear the more rigorous testing and design and construction of consumer products, as well as more rigorous delivery of consumer services. Thank you very much.

COMMENTS ON EUROPEAN DEVELOPMENTS: EUROPEAN CONSUMER INTERESTS

Ms. Benedicte Federspiel

Member, Consumers Consultative Committee (CCC) of the Commission of the European Communities;
Head of Legal and Economic Division,
Danish Consumer Council
Copenhagen, Denmark

There are many differences between me and the previous speakers, but there are at least three: I don't have a tie with my shirt; I don't start with a funny story; and I'm going to criticize the draft Directive, but not for going too far, but for not going far enough.

1) Production and consumption constitute the economic foundation of modern industrial society. Production provides products, which are bought by consumers. One of the problems arising from this process lies in the fact that, while being consumed, a product not infrequently causes injury to the consumer's or a third party's person or damage to their property. It should at the outset be noted, as it was stressed by Mr. Begam yesterday,[1] that there would be no product liability problem if manufacturers did not put any products on the market which are defective and cause injury or damage to the consumer. Unfortunately, manufacturers continue to place unsafe products on the market—televisions that catch fire, garments that ignite, hammers that chip, ladders that break, just to mention some of those unsafe products recently found by the White House Interagency Task Force on Product Liability. As manufacturers continue to place unsafe products on the market, we consumers are continuously exposed to the risk of products causing personal injury or damage to property. This risk has increased with the rapid development in the consumer market with its constant introduction of new articles. Today the consumer has to face an unlimited and still increasing number of products of a highly artificial and complex nature, also one of the probable causes mentioned by the Interagency Task Force.

2) When a product-caused injury is sustained by a consumer, an economic loss will arise. The law cannot do away with this loss.

---

[1] First World Congress on Product Liability, London, January 20, 1977, The Insurance Question: The Plaintiff's Lawyer's Viewpoint, Attorney Robert G. Begam.

But the law can remove it from the individual consumer. Up until now European law on product liability has mainly been based on faults. The notion of fault does not constitute an appropriate basis for a product liability system. A fault liability system places to a very large extent the risk of product damage on the consumer. This is not a fairly balanced solution in a modern industrial society which should guarantee the consumer the right to safety by ensuring that production is adapted in such a way that the products will not cause harm during use and by securing compensation for the consumer in case of product damage. The problem is one of social policy, the main question being whether the risk of product damage should be borne by the consumer or the producer/supplier. Placing the risk on the producer/supplier through strict product liability is the only adequate answer to this question.

Just as Lloyd George maintained at the beginning of industrialization that the cost of the product should wear the blood of the workman, the cost of the product should, as a matter of social policy, wear the blood of the consumer. The manufacture of a particular product should pay for itself.

It is only equitable that the cost of product damage should not remain with the injured consumer on whom it fortuitously falls, but should be spread among all the consumers. Such a spreading of the loss connected with product damage is generally most aptly obtained by transferring the loss to one or more links in the chain of production and supply through a strict liability system. This will make the loss to a cost of production and supply, a cost which may or may not influence the price of the product.

Furthermore, strict product liability will increase consumer protection by encouraging those links in the chain of production and supply on which this liability is placed to improve the safety of their products or their quality control. Strict product liability provides in this way for a very important supplement to statutory product safety regulation aimed at preventing product damage. Up until now, manufacturers have paid all too little attention to the question of total quality control. It is only recently that the heated product liability discussion and the growing awareness as stated by the White House Interagency Task Force are becoming effective spurs towards inducing manufacturers to produce safe products.

The European consumers understood, as has the Consumers Consultative Committee of the Commission of the European Communities; therefore, it strongly supports the new developments in the product liability field initiated by the Council of Europe and Commission of the European Communities which aim at introducing a strict product

liability system.

3) It is, however, a question not sufficiently looked into, whether, and to which degree, the product liability law and insurance might be replaced by a no-fault system providing consumers injured by products with compensation directly from an insurer regardless of fault or defect. When regulating the law of product liability, the question of how the victim in fact gets compensation cannot be neglected.

It is the intention of the strict product liability system proposed by the European Community and the Council of Europe that the costs of product liability shall be borne by the consumers. In return they should be assured compensation in case of liability. The consumers should not collectively spend their money to the benefit of the individual victims unless the victims effectively are secured compensation. The question of securing the victim compensation at the time the product is placed on the market cannot be ignored. Otherwise the consumer injured will be without protection in case of a "fly-by-night" producer, in case of bankruptcy of the producer, or in case of a catastrophic damage where the producer is unable to pay all the damages.

We agree to the principle that primarily the manufacturer should be liable for damage caused by products not duly safe. This primary liability should be an incentive for the producer to improve the quality of his products and to avoid the marketing of products not sufficiently subjected to quality control, thus preventing product damage. Establishing a state fund compensating product damage would entail the danger of taking this incentive from the producer unless such a fund were fed by the producers.

Considering the variety of products, the number of producers, the different geographical situations, and the varied financial characteristics of enterprises, we admit that it would probably not be feasible to have a uniform, general system of compulsory insurance. For one thing, it might be difficult to ensure that all producers take out insurance. However, it should be emphasized that as to the practicability of a system of compulsory insurance, this will vary considerably from one line of trade to another. While a system of compulsory insurance might be impracticable in the area of foodstuffs, it seems quite practicable in the area of drugs, motor cars and other products, the marketing of which needs a sort of administrative authorization. A study of the practicability of a system of compulsory insurance in a different line of trade should be undertaken in order to complete the proposed strict liability with provisions on compulsory insurance in those lines of trade where such a system will be practicable. Recently, a Swedish Government Commis-

sion proposed in the field of medically-caused injuries a kind of compulsory accident insurance to be paid for collectively by drug producers and importers.

In order to secure compensation of the victimized consumer in cases where this cannot be obtained through a compulsory insurance system, the European consumer asks for the initiation of a public fund, either in the form of a general state fund fed by industry or in the form of a number of funds, one fund for each of the different branches of industry. The establishment of such funds seem to be the only way to ensure that the victim is paid the damages he is entitled to in cases where this cannot be obtained through a compulsory insurance system.

4) As you will all know, the EC-draft Directive does not give the manufacturer the benefit of a state of the art defense. The European consumer welcomes the inclusion of development risks under the strict liability.

It should be pointed out that the legal concept of development risk is questionable, as the concepts of "scientific undiscoverability" and "technological feasibility," as Mr. Bloch clearly said this morning,[2] are themselves very doubtful. At any rate, modern industry, with its tremendous research facilities, should not be encouraged to give up the search for safer products as the case would be if development risks were not included under the strict liability. Furthermore, the principle of equitable allocation of the risk applies as much to undiscoverable as to discoverable defects. The burden of those scientific limitations of modern industrial society which might exist should not be cast on the individual consumer hit thereby but should be borne by all consumers.

5) According to the EC-draft Directive, the victim must prove the damage, the defect and the causal link between the defect and the damage. It is not fair to the consumer to place the burden of proof for causation and defectiveness on him. This was also implied in the statement we heard today made by Ralph Nader.[3] The producer is the one who best knows the features of his product. The producer is in a position both economically and scientifically to be able to provide evidence more easily which proves the absence of a defect as well as the absence of a causal link between a defect and

---

[2] Id., January 21, 1977, Product Liability and the Injured Party: Product Safety, Mr. Byron Bloch.

[3] Id., January 21, 1977, Product Liability and the Injured Party: Product Liability and the Consumer, Mr. Ralph Nader.

the damage. On the other hand, it will be, in most cases, a very hard task for the average consumer to prove the presence of a defect as well as a causal link between the defect and the damage. The questions of defectiveness and causation are very complex, and placing the burden of proof on the consumer in cases involving modern industrial products of a highly complicated nature means that strict liability will hardly be any better as a consumer protection remedy than is fault liability.

The consumer should only prove the damage and render probable the existence of a causal link between the product and the damage. If the consumer is able to do so, the producer should prove that the product was not defective or did not cause the damage.

6) The strict liability system in the draft Directive does not provide the allergic consumer with any protection. However, adverse reactions to products should be seen as an inevitable cost of the availability of products. The risk is universal that persons will react adversely to cosmetics, drugs, dyes, rubber, polishes, or to any manufactured item, but especially those intended for use as, or in, clothes, or for application to the human body. This problem was also mentioned by Mr. Belli today when he mentioned the case with the rose dust that for years had been used on Mexicans by immigration officials.[4] The existence of a marginal group of allergic consumers is known or should be known to the producer, while the individual consumer very often does not know of his allergy. The risk of allergic reactions will be foreseeable to the producer, who normally will be in the best position to evaluate the risk. It will not be of deterring proportions on an overall basis, while it will be a heavy burden to the individual consumer hit by it. Since the risk can easily be covered by the producer through his price policy or by means of insurance, it is not equitable that the consumer, with whom this risk happens to manifest itself, shall carry the risk inherent in the particular production. Cases of allergic reactions lend themselves particularly well to be covered by the strict liability system in the draft Directive, the basic idea of this liability being to remove the economic consequences of accidents from the victim who is unprepared to bear them and to place the risk on the enterprise in the course of whose business they arise so that the loss can be efficiently distributed among the community of consumers.

Many of the adverse reactions to products that do occur might be prevented, often without sacrifice of the benefits of the

---

[4] Id., January 21, 1977, Product Liability and the Injured Party: The Move Towards Larger Awards, Attorney Melvin M. Belli.

products, if the producer would do further testing or provide the consumers with more accurate information about the hazards and how to avoid them. Strict liability for allergic reactions would certainly put a strong incentive on the producer to do his best to prevent such reactions.

7) The national laws of almost all countries traditionally have developed an important distinction between sales and services. All countries have a rather detailed system of statutory rules governing the sale of goods, while services to a large extent are left unregulated by statute, although some statutory rules have been introduced for specific types of services—for instance, transportation. A different regime for sales and services in the field of product liability is, from the consumers' point of view, irrational. A comprehensive product liability system should cover all sorts of products and services. It is difficult to see how the movability of a product may be a convincing basis for a distinction between products which should or should not be exposed to strict liability. Products and services, movables and immovables, all have to function in connection with each other and will be used in complex situations of which they all are integrated parts. To place a strict liability on the manufacturer of an article, which has to be installed, without placing such a liability on the craftsman, who installs it, is a way to enable both to evade liability by claiming that the damage is due to a product defect or defective installation, respectively. To the injured consumer it is just the same whether the damage was caused by a movable, an immovable, or a service. The policy reasons for imposing strict liability for damage caused by movables are equally applicable to damage caused by immovables or services. That immovables should be exposed to the same strict liability as movables seems especially obvious in the case of mass-construction houses. It is a fundamental defect in the proposed European strict product liability that it is limited to movable-caused product damage.

8) The proposed European strict product liability system is not—as it ought to be—a comprehensive product liability system but mainly a producer's liability system. It is, however, of vital importance to the consumer to view as a whole the liability of the producer and the liability of the distributor as well as the other links in the chain of production and supply. As Professor Prosser has maintained, there are sellers other than the producer of the product. It will pass through the hands of a whole line of other dealers, and the consumer may have a good reason to sue any or all of them. The producer is often beyond the jurisdiction of the consumer. He may have left the market-place, and it is often impossible to pin liability upon him. Even where there is a proved defect, the maker will not be liable if the article was not defective when it left his plant. And the cracked bottle may have been cracked

long after it left the producer's plant. And even when the defect is fixed upon the producer, he may turn out, in these days of chain stores and large supply houses, to be a small concern, operating on a shoestring, and financially the weakest link in the whole chain of production and supply. Limiting liability to producers provides an inadequate remedy to injured consumers. It is a step away from the goal of an optimal system of compensation for injuries from defective products.

In view of the trend towards increasing specialization and the consequently growing need for cooperation, the question at issue should not be whether a single link in the chain of production and supply, say the producer, is too weak, but whether the chain, as a whole, is strong enough. When damage is caused by a product not duly safe when passing from the chain of production and supply to the consumer, "strict" liability should apply. The chain of production and supply must function as a whole. In case of any malfunction, strict liability should apply. Allowing the manufacturer to evade liability by proving that the product was not defective when it left his plant means that the consumer in many cases will have to run from pillar to post with his claim. The consumer will normally not know whether the defect arose at the one link or the other. The different links in the chain will, in relation to the consumer, have a common interest in trying to evade liability for any link by passing the buck from one link to another. The consumer should not be burdened with taking part in resolving at which link the defect arose. Mr. Belli's example this morning of the several persons who could have fired the shot in question illustrates this very clearly.[5]

I also want to stress that it is just as important to put a strong incentive through strict liability onto the supplier as onto the producer, in order to prevent the marketing of products not duly safe. Although the great majority of products leave the producer in the state in which they reach the ultimate consumer, it is an oversimplified approach to regard the function of the distributor or supplier only as one of distribution or supply.

Production and marketing structures vary a great deal from one line of trade to another and are in no way stable. Sometimes the producer is the commercially dominating link in the chain. In other cases it may be the supplier. The relationship between the large supply houses and chain stores and their suppliers is very much the same as between the motor car manufacturers and their dealers. The risk of the inability of the producer to pay compensation should not be placed on the individual consumer but on the supplier,

---

[5] Id.

who will be in a better position to absorb and distribute the costs of injuries.

On the whole it cannot be urged strongly enough that any link in the chain of production and supply—not only the producer—should be strictly liable for damage caused by a defective product, provided that the product was defective when it left the link in question. It might be argued that the inclusion of suppliers under the strict liability approach is uneconomical, because an arbitrary inflation of the retail price of the product would result from the duplication of insurance premiums paid for similar protection by the two different classes of potential defendants—the producer and the supplier. However, the supplier's insurance policy will not be similar to the producer's. A supplier will only have to pay ultimately for an injury when the producer cannot be found liable or cannot pay or did not cause the product to be not duly safe. The probability of a supplier's ultimate liability will be considerably lower than a producer's and the level of his insurance premiums will be correspondingly lower. Rather than duplicating charges for social costs of injuries, it fixes a charge for the social costs involved if a producer cannot pay. Thus, the cost-spreading goal of the strict liability approach is furthered by the inclusion of the supplier within the strict liability approach.

9) From a consumer point of view, it is not acceptable that the proposed strict liability system holds compensation for pain and suffering and other non-pecuniary loss unrecoverable. The law of tort generally allows a victim to get compensation for such loss. A change in the basis of liability does not justify a change in the types of losses recoverable. And I was therefore happy to note that Professor Diamond also brought out this issue.[6]

10) While the ministers in the Council of Europe did not find justified any limitation as to the amount of compensation to be paid by the producer, the Commissioners holding office in the Commission of the European Communities have ventured to suggest to the Council of Ministers such a limitation.

It has to be realized that any limitation as to the amount of compensation to be paid by the producer deprives the injured consumer of his right to receive full compensation. Such a limitation

---

[6] Id., January 21, 1977, European Product Liability Developments: European Product Liability Developments Other Than EEC, Professor Aubrey L. Diamond.

is, therefore, in itself, detrimental to the interest of consumers.

Furthermore, it should be noted that an upper limit will not make the strict product liability more calculable and thus more insurable. Strict liability is just as insurable as fault liability. It is a technical matter for insurers to evaluate the risk and to assess the premium accordingly. A clause in an insurance policy covering the product liability of a producer limiting the total amount of money to be paid under the insurance during one year serves not only the interests of the insurer but also the interests of the producer. By paying a higher premium the producer can obtain a higher limit in the policy. At which amount the limit should be fixed in the policy depends on the risk involved. An evaluation of the risk will have to take into account a lot of concrete circumstances such as the type of product manufactured by the producer, the yearly output of that product, the total turnover of the producer's enterprise, number of persons employed, etc. Through a correct evaluation of the risk, the producer pays a fair premium which may be reflected in the price of the product. No matter which amount is proposed as the upper limit, the upper limit will only be, in extremely few cases, from an insurance point of view, the relevant upper limit. In some product liability insurance policies, the upper limit when evaluating the risk of this producer correctly will be considerably lower, and in some policies the upper limit should have been considerably higher. A statutory upper limit will certainly also be the limit in product liability insurance policies in those cases where a correct evaluation of the risk would have led to a higher upper limit in the insurance policy. This means that the price of the product will not reflect the risk involved, which contradicts the policy behind the strict liability. A statutory upper limit may also force producers to take out insurance with a correspondingly high limit, although a correct evaluation of the risk would have led to a lower upper limit in the insurance policy. This means that the price of the product will increase to an extent which is not justified by the strict liability imposed on the producer. The argumentation put forward by the EC-Commission in support of an upper limit is not valid. Such a limit only deprives the consumer of his right to get full compensation. It should therefore be totally abolished.

11) A rule on limitation according to which the limitation period does not begin to run before the injured consumer could reasonably have become aware of the damage provides for the better administration of justice and avoidance of abuses without sacrificing the interests of the consumer.

According to the EC-draft Directive the liability shall, however, be extinguished upon the expiration of 10 years from the

end of the calendar year in which the defective article was put into circulation. The European consumer disagrees completely with this rule. Of course, products wear out. They cannot be expected to last forever, but only in accordance with normal expectations and with customary maintenance. But according to this, a certain length of life can be fixed to any product. And the producer should definitely be exposed to liability as long as the product may reasonably be expected to last, thus leaving it to the area of contributory negligence whether the damage is due to the consumer's use of a worn-out or not normally maintained product.

The producer should not be exposed to liability for an unduly long period, but it is impossible to lay down a general rule deciding for all products which period of time will be the appropriate length, as the lifetime of products varies considerably from one product to another product—as eggs to bricks, for instance. It should also be mentioned that in some cases, as for instance in case of injuries caused by side-effects of drugs, the lifetime of the victim is more relevant than the lifetime of the product. This may be so also in case of development risk. Therefore, this proposal on limitation should be deleted altogether. Such a limitation rule does not only serve as a procedural device, but it is a means to hamper the consumer's unquestionable right to fair compensation for product-caused injuries. And as Mr. Farwell answered the question yesterday, it doesn't make the product liability more insurable. It is more or less an American idea aimed at limiting the defect in the special American system, defects that we do not have in Europe.[7]

12) I should like to close my speech with some remarks on quite another type of limitation of product liability. As you all know, legislation on industrial injuries insurance normally makes a distinction between, on the one hand, personal injuries occurring by accident and, on the other hand, occupational diseases. This distinction between injuries caused by a single momentary occurrence and injuries sustained as a result of a continuous, steady, adverse action is pertinent to the law of product liability. A distinction may be drawn between, on the one hand, momentary product damage resulting from an accident and caused by a single product, and on the other hand, accumulated product damage developing gradually during the constant use of one or more products of the same or different kinds. Frequently, the accumulated damage cannot be specified, nor can the causality be completely clarified. The development is slow and cumulative, so that the presence of danger and injury may not manifest itself for many years or for generations to come.

---

[7] Id., January 20, 1977, The Insurance Question: Product Liability Insurance, Mr. Frank L. Farwell.

It will be difficult, if not impossible, for the consumers to prove any causality between the injury and its source. Who is to be held responsible when the causal factors are numerous, unidentified and anonymous?

Just before lunch I was asked by a journalist whether I did not think that the gruesome pictures we saw this morning were not overdoing it; and during lunch I was also asked whether I was not shocked by them. Sure they're gruesome; most people get shocked. But we have to realize that this is what lies behind the legal terminology of "damage to persons" or "personal injury." This is what we are talking about. This is the background for the discussion. Nobody's interested in ending up blind or partially maimed. So the best thing a strict liability system could bring is to make producers more concerned with safety measures in manufacture and design, so that we shall not see defective products to the same extent in the future. Thank you.

Part V: Product Liability Trade Association Surveys

Approximately 20 trade associations supplied data on the product liability problem from surveys they conducted within their industries. These surveys were analyzed by the Task Force's industry contractor in the Industry Study, and some of them were referred to in the Final Report. (See Industry Study, pp. IV-62 - IV-88.)

Two trade association surveys which were not previously available to the Task Force for reproduction but which were frequently cited in the Final Report are included in Part V. The first survey is "Products Liability: A MAPI Survey" (August 1976), conducted by the Machinery and Allied Products Institute, together with MAPI's follow-up to that survey entitled "Dimensions of the Products Liability Problem" (April 25, 1977). The second survey included below is the "NFIB Survey Report on Product Liability" (January 1977), conducted by the National Federation of Independent Business. The latter should be of particular interest to those persons interested in the impact of product liability on small manufacturing firms. The Task Force wishes to acknowledge the cooperation of MAPI and NFIB in granting the Department permission to reproduce these surveys.

MACHINERY & Allied Products INSTITUTE

MEMORANDUM

(202) 331-8430

1200 EIGHTEENTH STREET, N.W. • WASHINGTON, D. C. 20036

G-87

August 1976

PRODUCTS LIABILITY: A MAPI SURVEY

MACHINERY AND ALLIED PRODUCTS INSTITUTE

MACHINERY & ALLIED PRODUCTS INSTITUTE AND ITS AFFILIATED ORGANIZATION, COUNCIL FOR TECHNOLOGICAL ADVANCEMENT, ARE ENGAGED IN RESEARCH IN THE ECONOMICS OF CAPITAL GOODS, (THE FACILITIES OF PRODUCTION, DISTRIBUTION, TRANSPORTATION COMMUNICATION AND COMMERCE), IN ADVANCING THE TECHNOLOGY AND FURTHERING THE ECONOMIC PROGRESS OF THE UNITED STATES

NTIS is authorized to reproduce and sell this report. Permission for further reproduction must be obtained from the copyright proprietor.

Copyright © 1976
Machinery and Allied Products Institute
and
Council for Technological Advancement

Single copies of this memorandum have been distributed without charge to those member company executives who participated in the products liability survey and to the presidents of those companies surveyed. The price for additional single copies for those participating companies is $3.00. The price of a single copy for all other MAPI member companies is $6.00. For nonmembers, a single copy is available at $10.00.

Products Liability: A MAPI Survey

Foreword

Few problems confronting American industry have grown as swiftly as products liability. For a considerable number of companies this phenomenon has now reached a crisis stage.

The interest of the Machinery and Allied Products Institute in products liability dates back some 15 years and originated with the work of the Institute's Insurance Council. Our work in the field, encouraged by the MAPI Executive Committee, has included the continuing and enlarging attention of the Insurance Council, the publication of two full-length books--Products Liability and Reliability: Some Management Considerations (1967) and Company Programs To Reduce Products Liability Hazards (1972)--and a series of memorandums on the subject, frequent consultation with member companies, and, most recently, creation of a MAPI Products Liability Council. I think it is fair to say that no business organization has devoted more attention, research, and documentation to this subject than has MAPI.

Some months ago, in accordance with discussions with the MAPI Executive Committee, the Institute staff undertook the identification and development in some detail of possible alternative approaches to solution of the problem. In considering how best to embark upon this search, we enlisted the aid of certain members of the Insurance Council and the Products Liability Council who were--and are--possessed of unusual experience and expertise in the field. They agreed unanimously that an appropriate starting point for this quest would be a comprehensive survey of member company experience and attitudes respecting products liability.

A comprehensive MAPI questionnaire on this subject, developed with the aid of those member company executives who first suggested a survey, was transmitted to Institute member companies on March 4, 1976 and followed up late in April. This memorandum is devoted to a full report of the survey.

On behalf of MAPI, I want to express our keen sense of appreciation to all those member companies who completed and returned the long, detailed, and complicated questionnaire and especially to those member company executives who were so very helpful in the questionnaire's development. We hope that the full report which follows, by providing a badly needed data base, may prove of some assistance in the ultimate solution of the increasingly serious problem of products liability as a part of MAPI's continued and intensive work on the subject.

Charles W. Stewart
President

August 1976

Introduction

As detailed more fully in the report itself, the MAPI survey on products liability produced 210 responses across a broad range of industry with by far the greatest concentration in the capital goods industries. Given the size and the representativeness of the sample of companies responding to the MAPI questionnaire, we know of no other survey of products liability of comparable size or comprehensiveness. Moreover, with both the Congress and the Administration actively studying the products liability phenomenon, it seems to us that the release of survey results is most timely and a part of an essential prerequisite to designing a solution or solutions.

Certain difficulties were foreseen by those member company executives who assisted in the preparation of the questionnaire. It was suggested, for example, that--save for casualty insurance company reserves--there is no standard and accepted method of recording data pertinent to products liability claims. In whatever form such data is maintained, moreover, it will be retained for varying periods of time by individual companies. Again, it was pointed out, the greatly differing arrangements by which such companies insure against the products liability hazard--differences accentuated by company size and product line--might well produce noncomparable data. And as for suggested solutions, it was noted that any ideal solution or solutions--if such exist--face the uncertain hazards of legislative and judicial action. In some measure, all these difficulties--and others--were evidenced in the course of the survey. We do not believe they have impaired the survey's usefulness. Indeed, by helping to illuminate the breadth and depth of the problem, its extraordinary complexity and its rather obvious resistance to any easy solution, they may well have made a positive contribution.

The results of this survey of company experience with products liability contain few surprises for people who have lived with the problem over the years of its rapid growth. For the most part it supports and extends projections made from lesser bodies of data--although it is considerably broader in scope and deeper in sample of respondents than most earlier surveys--it verifies preexisting suppositions, and it confirms intuitive conclusions with objective fact. In addition it will provide, we believe, a new and broader perspective and, one hopes, some new understanding of a problem of surpassing complexity. For those interested in the subject a careful reading of the full report is recommended. However, because the full report is a long one and by way of an introduction and overview, we have summarized the survey's main findings below.

Highlights

The highlights of the full report are summarized below.

-- Some 210 MAPI member companies, representing a broad cross-section of industry, participated in the MAPI survey.

-- The experience of respondents indicates a sharp rise in both the number and amount of products liability claims over the past decade.'

-- For the period 1965 through 1975, 156 companies reported products liability suits filed against them in the amount of $826 million by plaintiffs' estimates; at the end of this period, 162 companies reported suits pending of $259 million with this figure based not on plaintiffs' evaluations but on amounts reserved against such claims by insurance carriers.

-- The majority of respondents have attacked the products liability problem by assigning special responsibility therefore to an individual or a committee; most such individuals or committees report to general management either at corporate or divisional level.

-- Almost all respondent companies carry primary products liability insurance coverage; a slightly higher percentage carry excess products liability coverage. The majority of respondents consider insurance coverage adequate, but nearly half consider the cost unreasonable.

-- More than 94 percent of those companies which answered the question indicated that their products liability premium rates had increased over the past five years, in addition, more than one-third of these companies were required to accept a deductible of a large retrospective retention. In percentage terms, the premium rate increase ranged from 0 to more than 4,000 percent with some 58 percent of the companies responding to this question reporting increases between 100 percent and 1,000 percent.

-- A significant minority of responding companies (16 percent) believe that the upsurge in products liability claims has inhibited the development of new products or contributed to the discontinuance of existing products.

-- Less than 10 percent of respondent companies believe that products liability can be solved without legislation. Of those who believe legislation is necessary, the great majority think federal or federal and state legislation is necessary.

-- The more important of respondents' suggestions for solving the products liability problem in descending order of popularity include the following:

(1) Eliminate contingent lawyers' fees.

(2) Make employer responsible where a work-related injury is caused by his negligence.

(3) Enact statutes of limitation concerning products liability which would restrict liability to a specified time period, limit liability to ownership by original purchaser, and free the manufacturer of liability where product has been altered or misused.

(4) Limit the amount of awards in products liability cases for damages other than medical and hospital expenses.

(5) Make workmen's compensation the sole remedy for a work-related injury.

(6) Improve product quality.

(7) Apportion fault between manufacturer and employer and other defendants in a work-related injury.

(8) Limit or eliminate altogether the doctrine of strict liability.

In concluding this introduction to the MAPI survey of products liability, it seems necessary to reemphasize the complexity of the problem and the elusiveness of any final solution. As in the fable of the blind men and the elephant, it is very possible to see products liability as a legal problem, or an engineering problem or a manufacturing problem or a marketing problem--or whatever kind of problem it is that an individual's personal blinders permit him to see. Products liability is, of course, each of these things. It is also all of them and therein lies the difficulty of solution and the improbability of clearing up the products liability mess by a single stroke, however inspired.

Just as the blind men, one by one, described the elephant according to what it was that each was able to feel of this strange creature so do approaches to the solution of products liability differ

according to the individual's vision of the problem. A good sized group holds that legislation is indispensable to the solution, some look to the courts, others insist that better products are the principal, if not the sole, solution. One important element of any final solution is already in being and takes the form of individual company programs to eliminate or mitigate the products liability hazard. Still others preach--and practice--the doctrine of vigorous and unyielding defense of products claims. One can only say--with some confidence--that there is no one solution to the burgeoning problem of products liability, a conclusion which seems fully borne out by the results of the MAPI survey.

Breakdown of Companies By Product Line and Size

Product Line Representation

Principal Product Line(s). (Please identify by 3-digit Standard Industrial Classification (SIC) Code, 1972 Manual.)

A total of 210 companies out of 480 surveyed took part in the survey. Respondents were asked to identify "principal product lines" by 3-digit Standard Industrial Classification (SIC) Codes. Activity in some 98 such codes, concentrated principally in "Manufacturing" but with limited representation in "Mining," "Construction," "Transportation and Public Utilities," "Wholesale Trade," "Retail Trade," "Finance, Insurance and Real Estate" and "Services" was reported by survey participants. Within these general classifications, 618 "principal product lines"--or an average of slightly less than three for each of the respondent companies--were represented in the survey.

To give some measure of the survey's scope, shown below by SIC code number and title are the numbers of principal individual product lines represented in the survey:

3-digit SIC Code No.	Title	Number of Respondents
331	Blast Furnaces, Steel Works, and Rolling and Finishing Mills	10
332	Iron and Steel Foundries	16
336	Nonferrous Foundries (Castings)	11
342	Cutlery, Hand Tools, and General Hardware	10
346	Iron and Steel Forgings	10
349	Miscellaneous Fabricated Metal Products	30
351	Engines and Turbines	7
352	Farm and Garden Machinery and Equipment	6
353	Construction, Mining, and Materials Handling Machinery and Equipment	59
354	Metalworking Machinery and Equipment	59
355	Special Industry Machinery, Except Metal-working Machinery	53
356	General Industrial Machinery and Equipment	62
357	Office, Computing, and Accounting Machines	9
358	Refrigeration and Service Industry Machinery	16

3-digit SIC Code No.	Title	Number of Respondents
359	Miscellaneous Machinery, Except Electrical	7
361	Electric Transmission and Distribution Equipment	5
362	Electrical Industrial Apparatus	17
363	Household Appliances	4
364	Electric Lighting and Wiring Equipment	6
366	Communication Equipment	9
367	Electronic Components and Accessories	14
371	Motor Vehicles and Motor Vehicle Equipment	19
372	Aircraft and Parts	14
373	Ship and Boat Building and Repairing	3
374	Railroad Equipment	5
381	Engineering, Laboratory, Scientific and Research Instruments and Associated Equipment	5
382	Measuring and Controlling Instruments	14

Company Size

Sales volume (please check one)

Volume of Sales	Number of Respondents
Under $10 million	25
$10 million - $50 million	53
$50 million - $100 million	29
$100 million - $500 million	59
$500 million - $1 billion	18
$1 billion and over	26
	210

I THE ANATOMY OF THE PROBLEM

Industrial Products vs. Consumer Products

	Yes	*No*
A. *Is your company's output limited primarily to industrial products?* (210)/1	191	19

1/ The figures immediately following the questions indicate the number of tabulated replies.

B. *If your company manufactures consumer goods, would you please indicate roughly what percentage they represent of total sales.* _____%

	Range
	9% to 95% /1

How Serious Is the Problem?

	Yes	No
C. *Does your company have a products liability "problem"? If so, how would you describe it. (Please check one)* (205)	183	22

	Number of Respondents
serious	38
potentially serious	96
costly, but not of great magnitude	36
de minimis	13
	183

II PRODUCTS LIABILITY CLAIMS EXPERIENCE

A. *Total claims paid and reserved (for years identified)*

(1) number of claims and (2) dollar value

The years "identified" were 1965, 1970, 1973, and 1975. As to each the respondent was asked to indicate both the number and dollar value of claims paid and reserved. The results follow with the number of companies responding to each question shown parenthetically after the answer.

	number	*dollar value*	
1965	6,641	$11,490,971	(159)
1970	7,084	51,414,421	(192)
1973	11,182	76,250,157	(193)
1975	9,865	81,236,281	(191)

The abrupt increase in amount of claims from 1965 to 1970 and beyond is accounted for in part, but only in part, by the disparity in numbers of companies reporting in the first of these years versus the last three. That difference, incidentally, is accounted for by the fact that a substantial number of respondents no longer have 1965 claims records. Notwithstanding this difference, a clear pattern of increase is shown in the dollar amount of claims paid and reserved by reporting companies over the period from which these years were selected. As for the number of such claims, the pattern of increase would appear to have been interrupted in 1975 for which some 1,300 fewer claims were reported than for the next earlier year of 1973. The appearance is an illusion, a false dawn. The

1/ Only 15 respondents or 7 percent of the total reported consumer goods sales of 20 percent or higher.

fact is that the 1975 figures reported--and to a lesser extent the 1973 figures--are preliminary only; more--and probably considerably more--claims assignable to 1975 will be reported in the future. A typical comment on the point says, "Many claims are not reported to us until two to four years have elapsed from the date of accident; this is particularly true of those claims involving industrial products. These claims have also been the company's largest claims."

To consider these figures from another standpoint, the average claim in 1965 was $1,730; in 1970 it was $7,258; in 1973 it was $6,819; and in 1975 it was $8,234. Thus, although the averages do not represent an unbroken pattern of increase the trend line is clearly upward.

(3) Size of claims (184)

	Number of Claims Paid and Reserved			
	1965	*1970*	*1973*	*1975*
under $1,000	4,285	4,181	4,492	2,584
$1,000 - $10,000	906	1,476	1,898	1,291
$10,000 - $100,000	195	530	849	492
$100,000 - $500,000	19	64	169	90
$500,000 - $1 million	2	11	15	41
over $1 million	0	4	17	11

Again, the trend in products liability claims over the period is clear and, consistent with our observations above, the figures reported for 1975 must be considered preliminary. Two comments of respondents deserve repeating. One says in respect to the pattern of claim activity, "The number of lawsuits filed against the _____ company in the product liability area increased from slightly over 100 lawsuits in 1965 to over 1,200 lawsuits in 1975." Another, quoting the "Cook County Jury Verdict Reporter" and addressing the size-of-claim matter on a comparative basis says, "Our Cook County court system here in Chicago recently compiled figures for a one-year period extending from September 1, 1974 through and including September 1, 1975. Such compilation of statistics reflected that $6.7 million was awarded to traffic collision litigants involving 225 collisions whereas $6.9 million was awarded in 18 cases of product liability litigation. In other words, there was an average award in Cook County last year in product liability litigation of $383,000 per case."

An analysis of the rise in the amount of claims over the period covered reveals some interesting numbers. Excluding 1975 figures for reasons already indicated, consider what has happened over the period 1965 to 1973 within the dollar brackets on which responses were classified. Claims under $1,000 (many of them doubtless "nuisance" claims) have remained at substantially the same level. But claims in the $1,000-$10,000 bracket rose from 906 to 1,898, or 109 percent; claims in the $10,000 to $100,000 bracket rose from 195 to 849, or 335 percent; claims from $100,000 to $500,000 rose from 19 to 169, or 789 percent; claims from $500,000 to $1 million rose from 2 to 15, or 750 percent; and claims over $1 million rose from 0 to 17, or by an infinite percentage. No doubt some part of this is inflation, but that alone cannot explain these phenomenal percentage increases.

B. Claims data for the period 1970-75

This question, subdivided into nine parts, sought both to summarize and analyze total claims data for the respondent company over the period 1970-75. Either because the data was not available at all or, if available, was not readily translatable into the form requested, some companies did not answer the question. Moreover, not every company which did respond answered every part of the question. The summary of responses, classified in accordance with the question's several parts and with the number of responses to each part of the question shown parenthetically, appears below.

	Number of Claims Paid and Reserved	*Amount of Claims*	
(1) total claims presented in the five-year period (1970-75)	16,785	$366,905,041	(176)
(2) claims paid by your company administratively without court action	4,396	8,675,282	(175)
(3) claims rejected by your company /1	2,858	35,414,537	(138)
(4) claims pending	3,272	176,663,709	(159)
(5) suits filed on claims against your company	11,768	828,465,205 /2	(156)
(6) judgments for claimants	212	22,059,978	(152)
(7) suits settled out of court	1,218	115,794,838	(156)
(8) judgments for your company /3	464	75,124,013	(133)
(9) suits pending	3,203	113,841,101	(161)

These are impressive figures. The enormous sums shown as "total claims presented" and "suits filed" represent in most cases the plaintiffs' demands and hence include a goodly measure of blue sky. However, the amount shown for "suits pending" represents not the plaintiffs' demands--or dreams --but the sum of established insurance company reserves or the company's best estimate of what the total of products liability suits against it are actually

1/ Many respondents simply indicated the number of claims rejected and showed no amount for such claims. Thus, the "Amount of Claims" in this case is derived from only 892 of the total of rejected claims reported.

2/ Some 34 percent of this total is attributable to one company.

3/ Here again many respondents reported judgments for the company without specifying the amount of claims involved. In fact, the amount of claims thus disposed of involves only 197 actual claims.

worth. The figure, incidentally, was checked directly in most cases with any company whose answer left any question on the point. In a few remaining questionable cases where it was impossible to verify the figures with companies involved, sums which were rather obviously the total of plaintiffs' demands were arbitrarily deflated on a ratio of 1 to 10.

As originally conceived, the 9 parts of this question were supposed to represent this equation: (1) - (2) through (8) = (9). However, the framers of the question did not reckon with the creativity of respondents who did not consider a lawsuit first brought to their attention as a "claim presented." Thus the balance intended to be struck is not achieved.

C. Products liability claims first presented during 1975 by type of claimant and class of product

This question comes at claims data from still another direction. It seeks to determine for the most recent complete year the comparative importance of three general sources of products liability claims: (1) employees of other companies; (2) members of the general public; and (3) insurance companies via subrogation. Typically, products liability claims involving capital goods are work-related. They frequently involve a suit against a machinery manufacturer by an employee of the manufacturer's customer who is injured on the job and alleges that the manufacturer's product was at fault. Thus, one may infer that most if not all claims arising under this classification are "capital goods cases." Moreover, employees injured on the job are compensated by workmen's compensation and where in the usual case such benefits are paid by an insurance carrier, the latter is subrogated--to the extent of benefits paid--to any rights the injured employee may have against a machinery manufacturer. This is, of course, situation (3) above.

As for the second of these categories of products liability claims, those by members of the general public, the majority of such claims are against manufacturers of consumer goods whose products are sold directly to, and are used by, members of the general public. A lesser, although still substantial, number of such claims may involve capital goods which come into contact with the general public (e.g., transportation equipment, construction equipment, etc.).

The summary of survey responses to this question appears below.

Claims by employees of other companies.--In this case, as in the case of responses to all three subparts of this question, more companies reported claims falling in this category than reported dollar amounts of such claims. A total of 1,385 claims from this source was reported by 187 participating companies. Only 164 of these companies reported dollar amounts of such claims amounting to $128,504,425.

There were 80 4-digit SIC product codes represented here with the vast majority in the following 2-digit SIC codes: 34--Fabricated Metal Products, Except Machinery and Transport Equipment; 35--Machinery, Except

Electrical; 36--Electrical and Electronic Machinery, Equipment and Supplies; and 37--Transportation Equipment. Among the specific 4-digit SIC codes showing the greatest activity (and it must be remembered that this question was limited to "Products liability claims first presented in 1975") were: 3531--Construction Machinery and Equipment (15); 3535--Conveyors and Conveying Equipment (7); 3536--Hoists, Industrial Cranes and Monorail Systems (6); 3537--Industrial Trucks, Tractors and Stackers (4); 3541--Machine Tools, Metal Cutting Types (11); 3542--Machine Tools, Metal Forming Types (6); 3559--Special Industry Machinery, Not Elsewhere Classified (7); and 3568--Mechanical Power Transmission Equipment, Not Elsewhere Classified (4).

Claims by members of the general public.--There were a total of 1,047 products liability claims falling in this category reported by 160 companies. Only 154 of these companies reported the amounts of such claims, the total of which is $176,068,864. (It should be noted, however, that this figure would be reduced to $79,787,011, if claims against 14 reporting companies whose sales are 20 percent or more in consumer goods were eliminated from the total.)

Respondents reported claims involving products in 72 4-digit SIC product codes. Those with the heaviest representation included: 3443--Fabricated Plate Work (Boiler Shops) (4); 3531--Construction Machinery and Equipment (10); 3634--Electric Housewares and Fans (3); 3714--Motor Vehicles Parts and Accessories (5); and 3823--Industrial Instruments [etc.] (3).

Claims by insurance companies.--There were 153 responses to this question covering 229 claims. Of this number of participating companies, 145 reported claims totaling $3,243,652. The great disparity in amounts between those reported here and those involving claims by employees of other companies and members of the general public is accounted for by the fact that any subrogation claim is limited to the amount of workmen's compensation benefits paid and includes no claims for pain and suffering, loss of consortium, etc. Moreover, a number of claims were reported as to which respondents indicated "no amount yet stated."

Responses to the last of the three categories into which respondents were asked to put products liability claims first presented during 1975 involve 53 different 4-digit SIC product codes. Inasmuch as claims by insurance companies via subrogation originate in on-the-job injuries which lead to allegations of faulty design or manufacture of some product used in the workplace, one may properly assume that such claims will be concentrated in the capital goods area. The summary of responses to this question bears out that assumption. Although claims classified in this category extend across the whole range of machinery and equipment and allied industrial products, the greatest number of reported claims were in the following: 3494--Valves and Pipe Fittings, Except Plumbers' Brass Goods (3); 3531--Construction Machinery and Equipment (5); 3536--Hoists, Industrial Cranes and Monorail Systems (5); 3541--Machine Tools, Metal Cutting Types (5); and 3559--Special Industry Machinery, Not Elsewhere Classified (5).

D. How many products liability suits and/or claims does your company now have pending?

There were 191 responses to this question and 15,131 suits and/or claims now pending were reported. This amounts to somewhat more than 79 suits and/or claims for each of these 191 companies.

III ORGANIZING TO DEAL WITH THE PROBLEM

		Yes	No
A. Does your company have any individual(s) or committee having special responsibility for products liability?	(208)	164	44

B. Where are they located?

Almost 80 percent responded affirmatively, a statistic which rather clearly indicates the widespread concern in industry with the problem of products liability.

As for location, 117 companies have such an individual or committee at headquarters with this total subdivided as follows: committee--38; individual--79.

Of those companies who responded affirmatively to the first question, 47 indicated placement of such an individual or committee at division or subsidiary level. Here the preference is for the committee approach with 28 favoring that and 19 having an individual perform the job.

A total of 50 respondents indicated coverage at both corporate and division levels.

C. To whom (title only) does any such individual or committee report?

A total of 142 companies answered this question with 113 indicating the reporting line at headquarters and 29 at division or subsidiary level. Some companies, as we have seen, have such organizational arrangements at both locations.

Of the 113 replies pertaining to corporate headquarters, the summary of executives to whom any such individual or committee reports breaks down as follows:

Title	Number of Respondents
President	32
Vice President (including those with and without special titles such as "VP-Engineering")	27
Senior Vice President	7
Executive Vice President	6
Secretary (including some who are General Counsel)	5

Title	Number of Respondents
Treasurer	4
Chairman	3
Chief Executive Officer	3
Group Vice President	3
General Counsel	3
Counsel	3
"Top Management"	2
Director of Insurance and Safety	2
Director of Product Integrity (or Product Assurance)	2
General Manager	1
Assistant Treasurer	1
Assistant to the President	1
General Counsel and Treasurer	1
Assistant Controller	1
"Senior Corporate Manager"	1
Director of Research and Development	1
Director of Financial Staff	1
Director of Engineering Staff	1
Director of Risk Management	1
Product Liability Coordinator	1
	113

As is obvious from this array, in the vast majority of cases the reporting line for any individual or committee at corporate headquarters charged specifically with responsibility for products liability runs directly to a member of senior management. This would appear to evidence top management's commitment to the problem's solution.

The pattern is the same at division or subsidiary level. Responses break down as follows:

Title	Number of Respondents
Division President (including "CEO")	7
Vice President	7
Division (Subsidiary) Manager	5
Group Vice President	2
"Division Head"	2
Senior Vice President	1
Group Manager	1
Division Controller	1
Director of Engineering	1
Product Safety Manager	1
"Varies by location"	1
	29

D. If a committee has responsibility, what corporate functions are represented?

There were 93 companies which responded to this question. Among these companies are representation on such committees of management functions identified in the question as follows:

Function	Number of Respondents
Engineering	82
Manufacturing (quality control)	74
Risk Management/Insurance	68
Design	65
Law	60
Research and Development	58
Safety	55
Marketing	54
Advertising	41
Purchasing	28
Industrial Relations	17

Beyond those functions listed in the questionnaire, comments of respondents indicated representation on such committees of other management responsibilities including: Service, Parts Department, Product Support, Chief Administrative Officer, Training, Finance, Environmental Engineering, Toxicology, and Industrial Hygiene.

E. If a committee structure, who acts as chairman? (Title only) As executive director? (Title only)

Chairman.--Some 77 companies responded to the first of these two questions. Their responses reveal a remarkable diversity of approach to the chairmanship of any corporate or division committee with special responsibilities for products liability. As indicated by the subdivision of the summary of responses which appears below, 25 of these 77 companies have appointed a member of general management as chairman and 22 have entrusted the post to an engineering executive. Of the remainder, distributed largely on a functional basis, 9 quality control executives chair such committees as do 7 marketing and customer service executives and 5 risk (insurance) managers.

Chairman of "Products Liability" Committee	Number of Respondents
General Management	
President	8
Senior Vice President	3
Group Vice President	1
Vice President	6
Treasurer	5
Secretary	3
	26

	Number of Respondents
Engineering	
Vice President - Engineering	8
Vice President - Technical Director	2
Chief Engineer	2
Manager of Engineering	7
Manager, Engineering Standards	1
Director of Engineering Analysis	1
Field Engineering Manager	1
	22
Marketing and Service	
Vice President, Marketing	2
Vice President, Consumer Affairs	1
General Sales Manager	1
Director of Customer Affairs	1
Director of Customer Service and Quality Assurance	1
General Manager, Service Operations	1
	7
Quality Control	
Manager of Product Quality	5
Manager of Product Safety	2
Product Safety Engineer	1
Product Safety Coordinator	1
	9
Safety and Health	
Director, Occupational Health and Safety	1
Safety Engineer	1
	2
Law and Insurance	
General Counsel	1
Risk (insurance) Manager	5
Attorney	1
	7
Miscellaneous	
Director of Planning	1
Products Liability Coordinator	1
Assistant to the President	1
Assistant to General Manager	1
	4

Executive Director.--A considerable lesser number of companies--35--answered the query concerning the executive director of any "products liability committee" than answered the preceding question on the chairmanship. As will appear from the summary of responses below, one may infer that the question was not completely understood and that there was at least some confusion between the function of organizing and directing the affairs of any such committee and the managerial post to which the committee reports. Notwithstanding the relative paucity of response to this question, one further--and important--inference is at least suggested. Adding the total of senior executives--10--represented to be "Executive Directors" (and one doubts if they are in fact preparers of agendas and carriers of paper on committee matters) to that number of responses--8--indicating that there is "none" [i.e., Executive Director], the result is 18 or more than half those companies which answered this question. From this, one could conclude that some such committees have an occasional or ad hoc rather than a continuing existence because an "Executive Director" devoting all or most of his time to committee affairs would seem to be essential to a continuing committee life. Although it is not clear from answers to the question, it must be concluded that the function of "Executive Director" may be performed without that title or any title being assigned.

Executive Director of "Products Liability Committee"	Number of Respondents
General Management	
President	4
Executive Vice President	3
Vice President - Operations	1
Division President	1
Division General Manager	1
	10
Research, Development and Engineering	
Vice President, Research and Development	1
Director of Research, Development and Engineering	1
Plant Engineer	1
	3
Quality Control	
Manager, Product Safety	2
Product Safety Engineer	1
Division Manager - Product Integrity	1
	4
Miscellaneous	
Vice President, Corporate Development	1
Controller	1
Insurance Counsel	1
"Industrial Relations"	1
"Same" (i.e., same as Chairman)	6
"None"	8
	18

	Yes	No
(1) *does either devote full or substantial time to this function?* (87)		
If so, which one? (14)	28	59

Full-time to committee function.--This question was concerned with whether or not any "products liability committee" has a day-to-day existence which would seem most likely only if someone devoted all or a substantial part of his time to the affairs of the committee. Of 87 responses to the first question, 28 said "Yes" and 59 said "No." There were only 14 responses to the second question, of which 3 indicated that, respectively, the chairman, the president and the corporate secretary devoted "full or substantial time to this function." One doubts it. The remaining responses, as summarized below, seem more likely to represent situations in which full or substantial time is so devoted.

	Number of Respondents
Senior Executives	
Chairman	1
President	1
Secretary	1
	3
Quality Control and Engineering	
Manager of Product Safety	4
Director of Engineering Analysis	1
Chief Industrial Engineer	1
Safety Engineer	1
	7
Law and Insurance	
Corporate Risk Manager	1
Director of Safety and Insurance	1
Attorney	1
	3
Miscellaneous	
Assistant to the President	1
	1

F. *Does any such committee or individual have special responsibility for:*	Yes	No
approval of product design (127)	73	54
approval of a product for manufacture (127)	66	61
approval of advertising (128)	74	54
recall of a product (125)	69	56
settlement of product claims (130)	85	45
control of product liability litigation (130)	93	37
insurance coverage (131)	87	44
approval of instruction manuals (126)	83	43
other:		

(1) special responsibility for regulations and codes

(2) approval of warning signs and labels

(3) tracking claims; investigating claims

(4) accident investigation; selection of defense counsel; authority to try or settle; selection of expert witnesses; determination of whether to cross-file against suppliers or dealers

In pursuing the general question of how a company may be organized to anticipate and deal with products liability questions, we asked whether or not any committee or individual assigned to this area had special responsibility for a variety of pertinent management decisions. Beyond these decisions, which are covered in the summary of responses appearing above, respondents were asked to indicate additional areas of decision or action for which any such committee or individual might have responsibility. (Slightly differing numbers of companies answered the individual questions; the number of respondents to each is shown in parentheses.)

	Yes	No
G. *Have you a written corporate policy on the retention of records (e.g., design, manufacturing, purchasing, testing, inspection, pertinent standard operating procedures, etc.) which may affect potential products liability claims?* (181)	106	75

Any manufacturer may one day face the necessity of proving in court the care with which his product was designed, manufactured, tested, etc. On such an occasion corporate records are an indispensable element of the necessary proof--hence this question. There were 181 responses including 106 companies who said "Yes" and 75 companies who said "No."

	Yes	No
H. *If the answer to "G" is "Yes," is such policy strictly enforced?* (101)	77	24

Accompanying comments provide at least some suggestion that companies which have no such policy or, if they do, do not enforce it, are reexamining the question. And one says "Enforcement is a never ending battle."

IV PRODUCTS LIABILITY INSURANCE COVERAGE

	Yes	No
A. *Does your company have primary products liability insurance coverage?* (188)	180	8

If answer is "No," please comment

From those who said "No," we received such comments as these:

. . . service policy with excess coverage above a sizeable deductible.

Retro-rated policy with $25,000 retention for each occurrence.

Funded self-insurance, $250,000 per occurrence.

After February 1976 the company will self-insure primary coverage.

Self-insurance retention of $100,000 plus expenses.

Self-retained risk of $250,000 per occurrence.

Company has substantial self-insurance retention.

One respondent which affirmed that it had primary coverage qualified its response by saying, "But 'retro,' so really not primary coverage."

* * *

Insurance coverages, like pickles, come in a wide variety. As an example of this, all products liability coverage is not provided by the products endorsement on the standard CGL policy. There are special forms of coverage for risks excluded by that endorsement or amounts of coverage beyond that provided by the basic policy. To obtain some general profile of products coverage among respondent companies, a series of additional questions, beyond that pertaining to primary coverage, was asked. Those questions and the responses appear below.

	Yes	*No*
Does your company have excess products liability insurance coverage? (187)	178	9
Does your company have aircraft products liability insurance? (186)	78	108
Does your company have nuclear liability insurance? (187)	24	163
Does your company have other specialized forms of insurance coverage involving the products hazard? (187)	27	160

	Yes	*No*
B. *If you have such insurance, do you consider it to provide adequate coverage?* (173)	159	14

(1) if answer is "No," in what respect is it inadequate?

Negative comments were accompanied by such comments as the following:

Inadequate because of restrictive language.

Limits now available in the market may be inadequate.

Loss or damage to company's products not covered.

Does not cover design error.

Based on recent trends we have no idea what is adequate.

	Yes	*No*
(2) do you consider the cost reasonable? (173)	93	80
(3) are you satisfied with the performance of your insurance company as to		
-- *preventing accidents* (150)	102	48
-- *defense of actions* (165)	135	30
C. Have your products liability premium rates increased over the past five years? (205)	194	11

If so, for what reasons?

As might be expected, not all those companies which said "Yes" commented on the reasons. However, 167 did comment--with each company usually suggesting several reasons--and their comments conform to a pattern with the same reasons being assigned repeatedly. An array of those reasons appears below with an indication of how many companies felt each such reason applied to them.

	Number of Respondents
Increased claims against, and losses by, respondent	51
General insurance market conditions	37
General rate increase	29
General experience in respondent's industry	20
Inflation	18
Generous jury awards	15
Increasing volume of litigation	11
"Consumerism" (including social and legal attitudes)	8
Increased sales volume	6
Increased severity of claims	5

	Number of Respondents
Strict liability doctrine	3
Increased aircraft hazard because of increased payload	2
More product units in the field	2
Increased subrogation by insurance companies	1
New products	1
Greater insurance reserve requirements	1
Governmental emphasis on safety	1
Growing antibusiness attitude	1

It should probably also be pointed out that this recital is made no less gloomy by the voluntary observations of several companies that further substantial premium rate increases are anticipated.

D. *Does your products liability insurance carrier require acceptance of a deductible or large retrospective retention?* (205)	*Yes*	*No*
	77	128

If so, what amount $ _____

Of those who responded affirmatively, 73 indicated the amount of the deductible required or the dollar limit of claims subject to retrospective rating.

The number of companies responding to the first question does not jibe with responses to the question concerning a deductible or retro. This is because some companies have two or more deductibles, varying by product, and other companies have both a deductible and are subject to a dollar limit on claims which, if exceeded, requires a retrospectively rated increase in premium. A summary of responses to the question concerning deductibles and/or retro follows:

Deductible Required (per occurrence)		Retro Limit	
0 through $4,999	6	$270,000	1
$5,000 through $24,999	10	$500,000	1
$25,000 through $49,999	9	$750,000	1
$50,000 through $99,999	15	$1,000,000	2
$100,000 through $249,999	21	$1,200,000	1
$250,000 through $499,999	6	$2,000,000	1
$500,000 through $999,999	6		7
$1,000,000 and above	4		
	77		

In addition to those responses summarized above, one respondent, whose answer is not included, indicates a "corridor deductible" from $25,000 to $100,000. Still other respondents, having answered "No" to the basic question, indicate that they have deductibles on their products coverage by choice. No doubt this is literally true, but one cannot fail to ask if the choice may not have been influenced by the premium that would have been required without the deductible.

	Yes	*No*
E. Have you had products liability insurance coverage cancelled? (194)	30	164

If so, why? (Please comment)

An analysis of the reasons assigned for cancellation--and some companies assigned more than one reason--reveals a recurrent pattern. Of the 30 companies responding in the affirmative, 9 indicated cancellation was the result of the carrier withdrawing from insurance of the products liability risk. "Poor claims experience" was reported by 7 companies whose products coverage was cancelled. An additional 7 companies, indicating generally that no reason for cancellation by their carriers was cited, have suggested that it resulted from an obvious reluctance on the part of carriers to insure the products risk. Three other respondents reported cancellation by the excess or umbrella carrier. Other reasons, which are in part variants on the themes already noted, appear in respondents' remarks quoted below.

> Insurance company did not want to continue on risk even though there were no reported losses at time of cancellation.
>
> Reinsurer cancelled on basis carrier.
>
> Insurance cancelled even though company had no claims.
>
> Carrier got out of business in our State.
>
> Several refusals to renew despite accident-free record for 14 years.
>
> Insurance carrier moving away from unprofitable lines.

V THE COST OF PRODUCTS LIABILITY

A. Some jurisdictions appear to have adopted the theory of "enterprise liability" on the assumption that the product manufacturer is the one best situated to distribute costs associated with injuries resulting from use or consumption of a product. It seems probable that little has been done in the direction of identifying and

segregating the totality of costs thus to be "distributed." As a step in that direction, would you please give us your best estimates, expressed as percentages, of the following costs including damage to the product itself and recall and retrofit.

(1) products liability insurance premium? (As a percentage of total sales) _____% (177)

More than half of the 177 companies which answered this question fall in the range of .1% through .9%. The full summary of responses, arranged by category, is as follows:

Range	Number of Respondents
.00001% through .00009%	2
.0001% through .0009%	6
.001% through .009%	11
.01% through .09%	29
.1% through .9%	105
1.0% through 1.9%	17
2.0% through 2.9%	4
3.0% and above	3
	177

(2) uninsured costs paid to others? (As a percentage of the insurance premium) _____% (108)

Of the 108 responses to this question, 57, or more than half, indicated no uninsured costs paid to others. The full summary of responses follows:

Range	Number of Respondents
- 0 -	57
less than 1%	14
1.0% through 4.9%	10
5.0% through 9.9%	1
10.0% through 24.9%	4
25.0% through 49.9%	8
50.0% through 99.9%	6
100.0% through 199.9%	2
200.0% through 499.9%	3
500.0% and above	3
	108

(3) internal costs not covered by insurance? (As a percentage of the insurance premium) ____% (126)

NOTE: "Costs not covered by insurance" might include the amount of any insurance deductible, staff salaries and overhead, costs of investigation and claim settlement, costs of litigation, etc.

Of the 126 responses, 23, or nearly a fifth, indicate zero internal costs covered by insurance. The full summary appears below.

Range	Number of Respondents
- 0 -	23
less than 1%	27
1.0% through 4.9%	16
5.0% through 9.9%	8
10.0% through 24.9%	24
25.0% through 49.9%	13
50.0% through 99.9%	6
100.0% through 199.9%	5
200.0% and above	4
	126

B. By what percentage, if any, has the total of such costs increased over the past five years? _____% (159)

There were 159 responses to this question with 93, or 58 percent of the total, distributed between the 100% and 1,000% marks. The full summary of responses follows:

Range	Number of Respondents
- 0 -	10
less than 10%	1
10.0% through 24.9%	7
25.0% through 49.9%	13
50.0% through 99.9%	16
100.0% through 199.9%	34
200.0% through 499.9%	27
500.0% through 999.9%	32
1,000% through 1,999%	13
2,000% through 3,999%	3
4,000% and above	3
	159

VI NEW PRODUCT DEVELOPMENT

	Yes	No
A. *Have you any evidence that the upsurge in products liability claims has inhibited the development of new products or the discontinuance of an existing product or product line within your company?* (206)	33	173

If answer is "Yes," please explain.

As evidence of inhibitions created by the continually enlarging products liability hazard, respondents offered such comments as the following:

> We have discontinued manufacturing two _____ that were used in aircraft.
>
> Generally no, but several instances have resulted in discontinuance of certain product developments.
>
> [No, but] . . . certainly an item for increasing consideration.
>
> Not inhibited but has caused greater care in design, quality control, etc.
>
> We are considering dropping several products from our _____ division.
>
> A few new products have been limited in scope of distribution (i.e., not sold to consumer market) to prevent availability to "do-it-yourselfers."
>
> Made engineering personnel overly conscious to point of restricting and stagnating product development.
>
> Products risk is a consideration in continuation [of present products] and introduction of each new product.
>
> Engineering effort was diverted from product improvement to retrofit 25 to 50 year old machines.
>
> Certain tools are being phased out of the market.
>
> We have discontinued a line of controls . . . because of the products liability claims generated.
>
> We have discontinued selling (and joint development of) products which operate in line with ours. We also will not import products developed and made by our licensee.

We considered products liability insurance costs and potential claim costs in the development of advanced medical ____ to be such that we redirected product development into other fields.

[No] . . . however, serious consideration has been given to eliminating some products and accessories to products.

Products liability experience with a ____ line was the impetus for disposing of the product line. In future, other product lines may be affected.

Have reviewed products in group and discontinued ____ products.

Some old products are being redesigned. While this is a discontinuance it has placed emphasis on new product development.

Several examples wherein customers have shown need for new products . . . and which we could have developed . . . but which were delayed or abandoned because of products liability.

Present research expenditures are being allocated towards areas of less exposure to consumer and liability problems.

VII POSSIBLE APPROACHES TO A SOLUTION

We are aware that many member companies have already considered possible legislation or other solutions to the products liability problem. MAPI is not committed to a particular solution at this time. A variety of proposals which have been advanced are listed below following two general questions. We would appreciate your reaction to them, but we are particularly interested in your suggestions as to how this continually enlarging problem may be solved, or at least made manageable.

	Yes	No
A. *If products liability is a problem for your company, do you believe it can be solved without legislation (e.g., through contractual indemnification, court-made law, etc.)?* (187)	18	169

If so, how?

Although comments were specifically requested only in the case of an affirmative response, those who believe no solution is possible without legislation also had their say. Representative comments, both pro and con, appear below.

Legislation Not Required

Attorneys through Defense Counsels' Association should try to change rules of procedure to require acceptance of presumptions in favor of manufacture in event product has long since left its control or that product has been significantly modified by employer. Provision for these presumptions provided for in Restatement [of Torts] Ind, Section 402(a) but discarded or ignored by courts.

Existing insurance mechanism will adjust to distribute costs. Total costs will be passed along as part of product cost.

Contract indemnification better than legislation.

Any legislation would involve social consequences as a result of consumerism. Rather than look to that to minimize the problem, companies should improve quality control, install design review, maintain in-line inspections, maintain adequate records, review advertising methods, etc., to be in a position to know the products and be able to defend.

Legislation Required

Largely a third party problem. Therefore, solvable by contract indemnification only in a limited way.

As a supplier of OEMs we cannot require indemnification successfully.

Contractual indemnification ineffective.

Federal legislation is the only way out.

B. *If you think legislation is necessary, should it be* /__/ *Federal or* /__/ *State?* /__/ *Both Federal and State?* (175)

Federal	81
State	17
Both	77

Comments:

An analysis of accompanying comments reveals that 31 respondents favoring federal legislation stress the need for uniformity in the law as it affects products liability. A representative collection of comments appears below. Specific suggestions for legislative action appearing at this point in many responses are not quoted here, but rather are reserved for inclusion in the compilation of suggestions appearing at the end of this report.

Favoring Federal Legislation or Federal/State

It would be difficult and expensive to operate under 50 state laws.

State legislation would be non-uniform and result in "forum-shopping."

Federal Products Liability Act administered by State and Federal Courts.

[Favor federal legislation] . . . providing federal statutes could override state laws.

Federal legislation for uniformity but State legislation is required for limitation of actions.

Favoring State Legislation

Preferably State, but State and Federal if necessary.

No additional legislation. Government regulations are a Pandora's box.

Most applicable statutes (statutes of limitation and workmen's compensation) are state matters. May require federal legislation for uniformity.

Local problems should be resolved at local level.

"Consumerism" too deeply embedded in anticipations for federal legislation to do whole job. [Editor's note: This is reminiscent of another comment on the locus of possible legislation which asserted that it is " . . . necessary to curb 'welfare-consumerism'do-gooder' philosophy which is poisoning the country."]

C. *Certain proposals for solution of the products liability problem are listed below. Would you please indicate your reaction by a "favorable" or "unfavorable" answer and any comments you may have on any or all such proposals.*

	Favorable	*Unfavorable*
-- *making "no-fault" legislation--either mandatory or elective--applicable to products liability* (195)	79	116

Comments:

Again, there were strongly held opinions both pro and con, but mostly con, as reflected in the sample of accompanying comments which follows. (To ensure that the respondent's sometimes cryptic observation is fully understood, we have indicated in each case whether the vote was "favorable" or "unfavorable.")

> Cost benefits of "no-fault" are illusory. Will not solve problems fairly since it will not penalize the party at fault. (Unfavorable)
>
> Social implications would dominate and our costs would be loaded by underwriters to provide for claims which should be defensible. (Unfavorable)
>
> Massachusetts' "no-fault" auto experience too unfavorable to consider "no-fault" here. (Unfavorable)
>
> ["No-fault"] . . . tends to reward people who disregard safe practices. Duplicates workmen's compensation and unemployment compensation and would permit double recoveries. Would also increase insurance premiums. (Unfavorable)
>
> "No-fault," with addition that workmen's compensation and all collateral sources be treated as an offset. (Favorable)
>
> Cost of defense of products liability actions is usually far greater than court awards. This has contributed to insurance cost. "No-fault" will eliminate much costly litigation. (Favorable)
>
> "No-fault" should have a trial period of evaluation. (Favorable)
>
> Desirable to continue to adjudicate fault. (Unfavorable)
>
> . . . if basis of payments is clearly defined and amounts are reasonable. (Favorable)
>
> While this would reduce cost of defense, it would increase number of claims. (Unfavorable)
>
> No solution if it works as poorly as no-fault auto insurance has worked in Massachusetts. (Unfavorable)

In the history of the world, removal of responsibility from a person for his acts has never solved a problem. (Unfavorable)

If limits can be set, it would be very helpful. (Favorable)

Recommend "no-fault" products liability legislation to cover where the product is certified as having met acceptable standards; otherwise common law to prevail. (Favorable)

Do not favor low-risk companies subsidizing others. (Unfavorable)

Preferably mandatory. (Favorable)

-- *changes in workmen's compensation legislation to:*	*Favorable*	*Unfavorable*
(1) limit products liability exposure (187);	161	26
(2) make possible a contribution from a negligent employer (191); *or*	153	38
(3) provide that recoveries under workmen's compensation or hospital/medical insurance by injured workmen should be permitted as an offset against recovery (187)	164	23

Please describe changes you would recommend:

Changes recommended were numerous and wide-ranging and, to some degree, contradictory. For the most part, certain suggestions recur. Each such general recommendation is stated below indicating the number of respondents who support it.

Recommendations	Number of Respondents
The employer should be made responsible where a work-related injury is caused by his negligence.	33
Workmen's compensation should be made the sole remedy for a work-related injury.	21
Subrogation to an injured workman's rights by a workmen's compensation insurance carrier should be prohibited.	15
Workmen's compensation benefits should be raised to realistic levels.	11
Manufacturers should not be permitted to sue employers.	6

Recommendations	Number of Respondents
Workmen's compensation benefits should be offset against products liability recoveries.	5
If an employer violates state or national safety requirements, joining him as a defendant in a products liability case should be permitted.	3

Beyond this summation of general comments, a number of individual comments are of interest.

> Contributory negligence should be available as a defense against both employee and employer.
>
> Workmen's compensation is the original "no-fault" concept. [Ergo, it should be the sole remedy and the subrogation of rights to insurance carrier should be prohibited.]
>
> All parties potentially responsible--employer, employee and manufacturer--should be given a single hearing to determine relative responsibility and liability.

-- *immunity to products liability suits upon certification by a quasi-public agency that a product satisfied established safety and health requirements* (189)	*Favorable*	*Unfavorable*
	92	97

Comments:

A sampling of comments with "favorable" and "unfavorable" grouped separately appears below.

Favorable

> Fine for those [products] which can be certified if at reasonable cost.
>
> Immunity may be too strong but certificates should be recognized and given strong weight.
>
> Composition of quasi-public agency is critical.
>
> [Favorable] provided realistic standards are drawn.
>
> Legislation would be helpful. Even though ___ meets Federal safety standards, there is no immunity from suit, since these are considered minimum standards. Evidence that standards are met should be conclusive.

Unfavorable

Do not believe approach is feasible.

Such agencies have rarely accomplished their objectives. Manufacturers do not need additional agencies regulating them.

A setup for bribery. Also impossibly bureaucratic.

Of doubtful practical value and probably not legally permissible.

No agency could possibly possess required expertise in all areas.

	Favorable	*Unfavorable*
-- *proof of compliance with applicable safety and health legislation regulations to serve as a defense in a products liability suit* (197)	166	31

Comments:

In this case there was a clear, indeed overwhelming, majority in favor of the proposal as stated. A representative selection of respondents' comments on this suggestion--classified according to the view expressed by the commentator--follows. The comments chosen reveal not only solid conviction but dubiety and a considerable element of hope.

Favorable

Federal standards would be preferable to state standards.

Should be accepted as a defense to design defect allegations--not to defective workmanship or materials. Leave as a jury question whether or not safety and health regulations are in keeping with the state of the art.

Certification by recognized testing laboratories (e.g., Underwriters' Laboratories) should be admissible.

Should be more than a defense. It should create a conclusive presumption.

An affirmative defense but not an absolute defense.

. . . getting jural recognition of state-of-the-art is extremely difficult. If it can be accomplished legislatively, good!

Excellent in concept, but who approves? Do we want such approval?

Unfavorable

[Even] with full compliance all possibilities would not be covered and thus compliance would be an inadequate defense.

Such certification might be viewed as prima facie proof of compliance to be rebutted by plaintiff.

An administrative nightmare.

Impractical.

Should not be an absolute defense but should be admissible to show the diligence of the manufacturer.

Not politically feasible or practical. Too much power in a bureaucracy.

-- *legislation restricting*	*Favorable*	*Unfavorable*
(a) the amount recoverable by reason of products liability in any case (201)	162	39
(b) the period of time following sale during which a manufacturer may be sued for an allegedly defective product (202)	195	7
(c) the liability of the original manufacturer for injuries attributable to a substantial alteration or modification of the product by a third party (203)	195	8

Comments:

The consideration of these proposals evoked a considerable number of comments by respondents. Inasmuch as the vote is overwhelmingly "favorable," those comments reproduced below have not been segregated according to the individual view of the respondent-commentator.

(a) Such legislation might be declared unconstitutional; (b) A statute of limitations is a must. No product will remain safe forever.

Prime manufacturers should assume liability for entire product, including components, to eliminate duplicate insurance and expense.

Recovery should be sufficient to make the injured party whole. [However, there should be] . . . limitations on pain and suffering, loss of consortium, etc.

(a) Where a maximum recoverable amount is set, the maximum is generally sued for regardless of injury; (b) and (c) are already provided for in Restatement of Torts (2).

It is unreasonable and ridiculous that we had to defend ourselves in 1971 on a machine our predecessor shipped in 1929 which had changed hands several times. The user must be made responsible for safe operation whether he modifies machine or not.

(a) Amounts of recovery should be set by appointed fact-finding panel based on the injured person's current earnings and future earning capacity--not by a court; (b) a reasonable period from first use; and (c) comparative negligence principle should apply.

A ceiling is undesirable under (a). The jury would always give the maximum.

(a) Limit to amount obtainable under workmen's compensation; (b) liability should be limited to some percentage of estimated or actual life cycle; (c) only if causal connection can be shown between alleged defect and modification or alteration.

This is a very difficult area involving many issues of public policy and cannot be dealt with in summary fashion.

(a) Specific limitations by law on amounts recoverable for pain and suffering is needed to prevent run-away verdicts based on sympathy; (b) This type of legislation is definitely needed to permit insurers to foresee the risk and set rates accordingly and to eliminate unforeseen liabilities when transferring ownership of companies; (c) Needed is legislation limiting the judicially imposed rule of "foreseeable misuse."

	Favorable	*Unfavorable*
-- *the imposition of defense costs on the plaintiff if he is unsuccessful in his suit* (196)	156	40

This is a very popular suggestion. Despite the proposal's popularity, there are a number of thoughtful dissents among the selection of respondents' comments appearing below.

> Definite deterrent to "shotgun" attorneys working on a percentage.
>
> Highly recommended to reduce number of spurious claims.
>
> Would be unfair to many individuals who have no other way to seek a remedy.
>
> Injured employee should not be responsible but attorney who took his case should be.
>
> This would eliminate about 75 percent of claims filed.
>
> Such action would be unduly restrictive and would prevent plaintiffs with legitimate complaints from seeking legal redress.
>
> Would eliminate nuisance suits.
>
> Conversely, plaintiff ought to recover costs if he is successful. This would encourage more settlements and less trials.
>
> Charge defense costs to unsuccessful plaintiffs. Have plaintiffs' attorney's fees determined by court in accordance with quality and quantity of legal work done--not a flat percentage.
>
> So long as contingent fee system exists frivolous suits will continue.

D. *What is your suggestion for solution of the products liability problem? Please discuss*

There were 130 respondents who made specific suggestions for solution of the products liability problem. As in the case of proposals for change in workmen's compensation legislation, a majority of responses voiced recurrent themes. In attempting fairly to summarize this outpouring of suggestions, we have, first, summarized below in our own language common recommendations together with the number of responses which agreed to each, and, second, we have quoted a number of other suggestions which follow no pattern but nevertheless deserve to be noted.

General Recommendations

	Number of Respondents
Eliminate contingent lawyers' fee.	38
Make employer responsible where a work-related injury is caused by his negligence.	33
Enact a statute of limitation governing manufacturer's liability. (Included suggestions: (1) 10 years from date of first sale to first user; (2) make time coincide with depreciation schedule for particular machine; (3) alteration or misuse of machine should free manufacturer of liability; (4) limit liability to ownership by original purchaser; (5) apply higher standard of proof if product has performed satisfactorily for a specified number of years.)	26
Limit the amount of awards. (Including three who specifically noted limiting awards for pain and suffering. It seems likely that others intended this in calling for a limitation on "awards.")	24
Make workmen's compensation the sole remedy for a work-related injury.	21
Improve product quality.	20
Apportion fault between manufacturer and employer and other defendants in a work-related injury.	11
Limit or eliminate altogether the doctrine of strict liability.	10
Negligence should be punished.	5
Educate public to seriousness of products liability problem.	5
Defend all products liability claims vigorously.	5
Abolish punitive damages (including suggestions that any punitive damages awarded should be to State and not the Plaintiff and no contingent legal fees should be allowed thereon).	4
There is no one solution.	4

	Number of Respondents
Settle products liability cases by administrative rather than judicial action (including related suggestion to eliminate jury trials for products liability cases).	3
Arrange to pool products liability risks in a "captive industry."	3
Authorize judgments for continuing support rather than present value of future support.	2
Close at least half the law schools in the country.	1

Individual Suggestions

The solution lies in prevention at the design, development and pre-production evaluative phases as well as traditional quality control associated with manufacturer.

* * *

Since the problem is really a social and legal attitude which is becoming increasingly antibusiness and will probably not reverse, we recommend a "no-fault" approach.

* * *

Should differentiate between personal injury and property damage claims/lawsuits.

1. Personal injury claims/lawsuits

   a. Eliminate the collateral source rule except for individually purchased insurance coverages.

   b. Eliminate workmen's compensation subrogation and/or recovery.

   c. Allow a manufacturer a right of action against employer for its negligence without defense of workmen's compensation being an exclusive remedy.

d. Modify strict liability (Restatement 402a) to allow comparative negligence to reduce damages in accordance with plaintiff's failure to act prudently.

e. Statute of Limitations to run from date of first sale to first user.

2. Business or corporate property damage

a. Eliminate all causes of action except those under the UCC or negligence actions.

b. Statute of Limitations to run from date of sale in negligence cases.

(UCC Statute is now from date of sale.)

* * *

Consider a simple piece of equipment--a knife. Who cuts fingers with them? Obviously, the user. If knife manufacturer must be responsible for use he has two choices: One is to liquidate before going broke or going broke.

* * *

No class action suits without permission of claimants. Entire punitive damages award goes to state, no attorney's fees allowed. Reduce attorney's fees as claim increases. Strict liability rule only to first purchaser.

* * *

Legislation counteracting the strict liability theory as propounded in the Restatement of Torts [2] and case law would be desirable. If we move back toward a negligence-contributory negligence stance, . . . much of the product liability problem would be solved . . . . If a strict contributory negligence theory is considered too harsh, a comparative negligence theory can be considered.

Although Federal legislation appears to be needed to help correct a worsening product liability situation, I am disturbed by some of the suggested types of legislation heretofore mentioned. Striking out in a number of directions with immunity, no-fault, amending workmen's compensation legislation and setting up new

quasi-public bodies is not the answer. These suggestions are either impractical to implement through legislation or potentially undesirable if implemented.

Attempts at obtaining clearer standards for manufacturers to comply with and use of compliance as a defensive tool would go a long way toward correcting the present situation. If this were coupled with a legislatively endorsed return to the negligence-contributory negligence theories, the defensive posture of a manufacturer would be considerably improved.

This approach would not alleviate all product liability cases. No approach could, or should attempt such a sweeping change. If we face facts, we will have to admit that some product liability cases are justified. This approach does, however, have attributes to commend it. First, manufacturers would have clearer standards to comply with. Some such standards now exist thru OSHA, ANSI, and other bodies and others could be promulgated. Second, manufacturers would be more likely to comply with the standards if non-compliance could be used as evidence of negligence, but compliance could be used as evidence of non-negligence. Third, it would make the claimant responsible for his/her irresponsible acts that contributed to the injury. In other words, it keeps "fault" in the system. Fourth, it is clearly workable within our present judicial set-up and has, in effect, worked in the past.

* * *

The Federal government and states set limits on awards for damages other than property and medical. States [should] have a body which consists of five regular members and four outside "experts" in a particular case to act as judge and jury. Remove emotional decisions and awards. Appeals may be made through the state or federal court system at the appellate level. Loser pays all costs.

* * *

Place heavy evidentiary burden on plaintiff alleging a product defect if product has been in use ten years or more without prior sign of defect.

* * *

General insurance like automobile "no-fault" plus workmen's compensation tied to cost of living

index and adjusted to provide reasonable compensation. Go back to doctrine of privity and proved negligence rather than strict liability.

* * *

If management has the resources to design, produce and market its products, then it can also manage its liability exposure. If public demands quality and safe products, manufacturer should price accordingly.

MACHINERY AND ALLIED PRODUCTS INSTITUTE

DIMENSIONS OF THE PRODUCTS LIABILITY PROBLEM

A Status Report and Follow-Up MAPI Survey Supplementing the Comprehensive Survey Published in August 1976

April 25, 1977

April 25, 1977

DIMENSIONS OF THE PRODUCTS LIABILITY PROBLEM: A STATUS REPORT AND FOLLOW-UP MAPI SURVEY SUPPLEMENTING THE COMPREHENSIVE SURVEY PUBLISHED IN AUGUST 1976

The Dimensions of the Products Liability Problem

It is not uncommon to hear the twin declarations that there has been a significant increase in both the number and amount of products liability claims and a corresponding--and perhaps more than a corresponding --increase in products liability insurance costs. In August 1976, MAPI published the results of its survey on products liability which indicated that as of the end of 1975 (the latest data included by respondents), this kind of increase was indeed documentable.

To determine whether the problem had worsened since 1975--a conviction of many--MAPI undertook a telegraphic survey (copy attached) of some 55 member companies. The responses are clear:

1. Over 90 percent of the respondents (53 companies) indicated that since publication of the MAPI survey their companies had experienced an increased products liability problem.

2. About 98 percent of those respondents with an increased problem specifically cited higher insurance costs as one of the causes.

3. Slightly over 40 percent of these same respondents cited the increased number and amount of claims as contributing causal factors.

4. About 31 percent of the respondents with an increased problem indicated the lack of availability of insurance as a factor.

5. As to the magnitude of the cost increases for insurance, the range of responses includes one company which experienced an insurance cost increase of 2000 percent while the average cost increase was 262 percent.

The detailed responses follow.

Responses in Detail

1. Since publication of the MAPI survey in August 1976, on the basis of your company's experience, has the products liability problem -

	No. of Respondents
(a) Increased?	41*
(b) Decreased?	0
(c) Continued at same level?	12*
Total	53

Comment: *Seven of the 12 respondents indicating the problem was continuing at the same level specifically noted that their insurance cost has increased.

One of the remaining five observed his company is unable to determine if its insurance cost has increased since "our products liability coverage is part of a comprehensive liability policy and separate premiums are not available."

To sum up, the problem, when broadly defined to include insurance cost increases, has increased for over 90 percent of the survey respondents.

2. Note: 47 of 48 respondents, in effect indicating that the problem had increased, provided answers to question No. 2.

If the problem has increased, was this because of -

	No. of Respondents
A. Increased number of claims?	19
B. Increased amount of claims?	21
C. Increased insurance costs?	43
D. Unavailability of insurance?	15
E. Other reasons	12

Other reasons include the following:

-- An influx of claims involving occupational disease	1

	No. of Respondents
-- Insurance carrier pressuring to settle virtually every claim	1
-- Vendors and distributors can't get insurance and want us to protect them	1
-- Unable to buy anything but excess coverage	1
-- A jury award of $403,300 in a products liability lawsuit	1
-- Insurance carrier going out of business	1
-- Jury awards have increased considerably on products we manufacture	2
-- Tightening of umbrella market	1
-- Increased amount of standardized discovery with questionable relevancy or materiality and judicial relief totally lacking	1
-- Both increased judgments and settlements and increased types of claims, e.g., punitive, economic loss	1
-- Most of the claims against us seem to occur because of the physical adjacency of our product rather than any reasonable or logical tie-in with the injury	1

Comment: Several respondents indicated they did not have data on hand re amount and number of claims so the responses may understate the frequency of these problems as causal factors.

As to the unavailability of insurance, respondents interpreted "unavailability" to mean either a forced switch to umbrella liability over self-retained limits or the lack of availability at "reasonable" costs.

3. Note: 37 of the 43 respondents reporting increased insurance costs provided data on those increases:

30 respondents provided a single figure which is assumed to be the increased percentage in costs overall.

Seven respondents provided data showing cost increases broken down between primary and excess coverages.

A. Overall Increases

Percent Increases	No. of Respondents
0-10	0
11-25	3
26-50	6
51-100	7
101-200	4
201-500	7
501-1000	2
1001 and over	1
	30

-- Avg. for 30 respondents: 262%

-- The median for respondents: 82%

-- Almost half had increases over 100%

-- The low was 19% while the high was 2000%

B. Primary and Excess--Separate

	No. of Respondents	
Percent Increases	Primary	Excess
0-10	1	
11-25		
26-50	1	1
51-100		
101-200	3	1
201-500	1	2
501-1000		2
Over 1001		1

Comment: Among the pertinent comments offered by the respondents are the following:

-- Our extreme increase in the premium for our umbrella insurance--which we have never had to call upon--brings a dramatic new dimension to the problem.

-- It is very obvious that liability underwriters no longer wish to assume any kind of risk for any price. Rates and retentions have gone out of sight with very little consideration being given to a company's prior experience.

-- Despite a 15-year accident-free record, we have no assurance at this date of continued availability of insurance coverage. At a rate of over 2-1/2 percent of sales, we question our ability to continue to compete with others in our basic industry with a different product mix and product insurance costs reported as one percent or less of sales.

-- We switched to a captive insurance company, in part, to avoid increased insurance costs.

-- Unavailability of insurance at reasonable cost prompted us to go self-insured for primary level.

-- We increased our self-retention 400 percent in order to retain desired broad insuring agreements and approximately the same premium.

Conclusion

The responses make it very clear that insurance coverage presents a growing and significant cost burden. On the other hand, no attempt was made here to adjust either for increased sales or inflation. Such adjustments might affect the magnitude of the increased cost problem.

TELEGRAPHIC SURVEY ADDRESSED TO 55 MAPI MEMBER COMPANIES TO PROVIDE CERTAIN CURRENT INFORMATION ON PRODUCTS LIABILITY AS A SUPPLEMENT TO THE PRINCIPAL SURVEY PUBLISHED BY THE INSTITUTE IN AUGUST 1976

April 19, 1977

AS BACKGROUND FOR MAPI'S APPEARANCE APRIL 27 IN SENATE COMMERCE COMMITTEE HEARINGS ON PRODUCTS LIABILITY WE WOULD APPRECIATE A PROMPT TELEX REPLY TO THE FOLLOWING QUESTIONS:

1. SINCE PUBLICATION OF THE MAPI SURVEY IN AUGUST 1976, ON THE BASIS OF YOUR COMPANY'S EXPERIENCE HAS THE PRODUCTS LIABILITY PROBLEM -
   - (A) INCREASED? YES NO
   - (B) DECREASED? YES NO
   - (C) CONTINUED AT SAME LEVEL? YES NO
2. IF THE PROBLEM HAS INCREASED, WAS THIS BECAUSE OF -
   - (A) INCREASED NUMBER OF CLAIMS? YES NO
   - (B) INCREASED AMOUNT OF CLAIMS? YES NO
   - (C) INCREASED INSURANCE COSTS? YES NO
   - (D) UNAVAILABILITY OF INSURANCE? YES NO
   - (E) OTHER REASONS (PLEASE IDENTIFY AND EXPLAIN)
3. IF INSURANCE COSTS HAVE INCREASED IN THE PAST YEAR, BY WHAT PERCENTAGE? .....

IF THIS QUICK AND INFORMAL SURVEY PRODUCES USEFUL RESULTS ONLY AGGREGATE DATA WILL BE USED IN SENATE HEARINGS; NO INDIVIDUAL COMPANY WILL BE IDENTIFIED.

THANK YOU FOR YOUR ASSISTANCE,

CORDIALLY,
CHARLES I. DERR
SENIOR VICE PRESIDENT

NFIB SURVEY REPORT ON PRODUCT LIABILITY

JANUARY 1977

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

[illegible]



NFIB Survey Report on Product Liability

FIKE METAL PRODUCTS CORP.
BLUE SPRINGS, MISSOURI 64015

AC 816-229-3405
Wire Telex 04-2263
Cable Address FIMEPROD
704 South 10th Street

Mr. Wilson S. Johnson, President
National Federation of Independent Business
150 West 20th Avenue
San Mateo, California 94403

Nov. 10, 1976

Dear Mr. Johnson:

We have an extremely serious product liability situation affecting not only our company, but threatening all major industry in the United States.

Our company manufactures pressure relief devices called rupture discs and is one of only four in the country producing similar relief devices. The design of safety devices for over-pressure relief of all pressure vessels manufactured in the U.S. is established by law and design criteria. These criteria pertain to every chemical plant, refinery, power plant, boiler, and every storage container which potentially can be placed under pressure.

We manufacture these safety devices for all U.S. industries and many times the product has saved lives as well as extremely expensive plants and equipment. Insurance companies inspecting the various plants require these safety devices on all pressure vessels before they will write fire and general liability coverage. OSHA standards also require the use of these valves.

Even though we have never, in 31 years of operation, had any liability suits or judgments against us, our insurance company and all others we are negotiating with now tell us that, at best, our product liability will go from a 1975 rate of $5,000 to $100,000 plus; and at worst they will not underwrite our product at all. Their concern is not in defending our product as being safe and reliable but with the number of risks that they may have to defend and the prohibitive costs involved should they lose only one case.

If we are forced out of business because we cannot obtain product liability insurance then the entire U.S. industry collapses because it cannot obtain fire or liability insurance.

We feel that exemption of certain products from liability suits or mandatory compensation for all legal fees and expenses to manufacturers who are defendants in suits where it is proven that the product is not at fault are two possible answers so that reliable products could still be manufactured without threat of product liability insurance cancellation.

Yours truly,

FIKE METAL PRODUCTS CORP.

L. L. Fike, Jr.
President

TABLE OF CONTENTS

Page

Introduction
- Why an NFIB Product Liability Survey? 3
- Focus of the NFIB Product Liability Survey 3
- Methodology and Limitations of the NFIB Product Liability Survey.. 3

Summary 3

Small Manufacturers Carrying and Not Carrying Product Liability Insurance 4

Small Manufacturers Not Carrying Product Liability Insurance 4

Small Manufacturers Carrying Product Liability Insurance 7

Claims Against Small Manufacturers 8

Premiums and Claims Paid—A Substantial Difference 9

The Economic Impact 10
- Competition 10
- Inflation 11
- Employment 12

Commentary on Two Proposed Solutions 12

An Appeal 13

Appendix 14

INTRODUCTION

Why an NFIB Product Liability Survey?

NFIB became aware of the product liability "crisis" as a result of letters from its membership. Originally, the volume of correspondence more closely resembled a periodic drip than a flow, but through the spring and summer of 1976 it became a stream. Even then it was not the volume that spurred interest so much as the substance. Virtually every piece of correspondence was filled with urgency. It was not even uncommon for a member to advise the NFIB staff to forget taxes (a reference to NFIB's work on the Small Business Growth and Job Creation Act and later the Estate and Gift Tax legislation) and do something about product liability.

Most correspondence focused directly on the rapidly escalating rates of product liability insurance. Experience after experience was received reporting rates increasing by 500%, 1000%, or substantially more. Invariably such reported experiences were accompanied by phrases as 'and I have never had a claim filed against me', or 'and only one claim amounting to less than $1,000'. (See the backpiece for example letters.)

NFIB was gratified when the Department of Commerce in concert with the Small Business Administration produced a preliminary product liability report and devoted a rather substantial chapter exclusively to small business.[1] This recognition of small business as a distinct entity and the concern over any product liability problems or consequences unique to small business was one of the more encouraging Executive Branch initiated actions to occur in recent memory. But after reviewing the Inter-Agency Task Force on Product Liability's proposals for the systematic collection of data on product liability, NFIB became concerned that the Task Force could not provide sufficient information on gradations or degrees among small firms. "Small business" was to be considered by the Task Force a separate classification without distinguishing possible differences between larger small firms and smaller small firms. NFIB had no prior proof such differences existed and recognized that the Task Force must concern itself with all business, not just small business. As a result, the conduct of this survey should not be construed as tacit criticism of the Task Force's work. But it was this concern and the general urgency that motivated NFIB to undertake the survey.

NFIB hoped to complete the survey report in time to provide the Task Force with pertinent data and conclusions for incorporation into the Task Force's scheduled December report. Regrettably, the time consumed in analyzing NFIB's raw data prohibited such input. This survey report, however, is being widely distributed in the interest of providing decision makers with a greater understanding of the impact of product liability on small business.

Focus of the NFIB Product Liability Survey

At the outset, the decision was made to survey only NFIB's small manufacturer members. While it was recognized that the product liability problem extends considerably beyond manufacturers, it was feared that a survey beyond the manufacturing sector would so dilute the sample that the figures derived would permit little cross tabulations and, thereby, be of limited utility. Ideally, of course, all business sectors would have been included in the survey but the implication was tripling or quadrupling the sample size. Financial constraints prohibited such a massive undertaking.

It was NFIB's purpose in undertaking the survey to focus on many of the areas suggested by the Department's preliminary report as ones particularly in need of systematic data collection. Thus, the questionnaire (see Appendix for a copy of the questionnaire) was designed to elicit responses that would measure the economic impact of product liability on small manufacturers. But in so doing, the data provided an unintended dividend which shed light on additional questions.

Methodology and Limitations of the NFIB Product Liability Survey

NFIB has over 31,000 small and independent manufacturer members. A sample of one out of every seven was drawn from NFIB membership lists and a questionnaire was mailed to these firms October 8th, 1976. Of the 4,214 questionnaires mailed, 1,296 responses (30.8%) were received prior to tabulation.

Due to urgency and the unsuccessful attempt to make NFIB data available to the Task Force prior to their deadlines for preparation of the December report,the questionnaire was not field-tested. Fortunately, the problems experienced as a result were minimal. However, certain changes would have occurred, most notably division of some reponse categories and substitution of one or two questions.

Precautions must be taken when surveying small business by mail in order to ensure a sufficient response. The questionnaire must be short and not demand such precise responses that the respondent will be forced to check his books or call his accountant. The result is a necessary, but regrettable limitation on the information's precision and depth. This is of particular concern should one attempt to extrapolate specific figures from the survey to the entire small business population. The text of this survey report recognizes these limitations. Despite them, however, the information presented is valuable in that it provides trends, makes distinctions, allows comparisons, and generally gives a reasonable idea of size.

SUMMARY

1. Approximately three of five small manufacturers surveyed carry product liability insurance. Propensity to carry such coverage is directly related to firm size.

2. One in twelve, about 9%, of all firms surveyed, cannot afford product liability insurance and another 17% cannot afford desired limits. However, less than 1% cannot find anyone to insure them for any price. Almost 3% have "gone bare", once having had insurance and now not being able to afford it.

3. Product liability insurance rates are escalating at an alarming rate.

4. By the end of 1976, product liability claims against surveyed small manufacturers will have doubled over the past five years. Insurance payments to claimants will have risen significantly over the same period as well. Most claims settled that included some payment to a claimant are relatively small. However, a substantial difference exists between mean payments and median payments due to a few very large financial settlements.

5. Estimated premium payments of surveyed firms for the coming year will be approximately six times larger than payments made by insurors to claimants over the last 4¾ years.

6. The most significant finding of this survey is that one in eight surveyed small manufacturers have failed to develop a new (new for the firm) product and one in twenty is dropping a product due to the inability to obtain product liability insurance, the cost of product liability insurance premiums, or the threat of product liability suits. This type of impact is predominant in the "Fabricated Metal Products, Tools and Machinery" and the "Chemicals, Petroleum, Rubber and Plastics" sectors.

7. Prior increases in product liability insurance premiums caused 25% of the surveyed firms paying premiums to raise the price of their goods, and another 21% have raised or will raise their prices due to expected premium increases.

8. Claims filed against surveyed small manufacturers involving products over 15 years old, substantially modified, or not given routine maintenance account for less than 10% of all claims, but more than 50% of all dollars paid to claimants.

[1] "Product Liability Insurance Assessment of Related Problems and Issues" Bureau of Domestic Commerce U.S. Department of Commerce March 1976

NFIB SURVEY REPORT ON PRODUCT LIABILITY

SMALL MANUFACTURERS CARRYING AND NOT CARRYING PRODUCT LIABILITY INSURANCE

Almost three of five (58.5%) small manufacturing firms surveyed carry product liability insurance.

The existence of coverage is directly related to firm size (see Table 1). As firm size grows, so does the percentage of firms carrying product liability insurance. At the two extremes of firm size, the very largest small manufacturers are nearly three times as likely to carry product liability insurance as are the very smallest.

Table 1
SMALL MANUFACTURERS CARRYING PRODUCT LIABILITY INSURANCE BY FIRM SIZE
(in percent)

Gross Receipts (in thousands)	Carry	Don't Carry	N/A
Under $50	28.2	70.5	1.3
$50-$100	35.3	64.7	0
$100-$250	47.0	53.0	0
$250-$500	52.3	45.5	2.3
$500-$750	59.0	41.0	0
$750-$1,000	62.1	37.9	0
$1,000 and over	78.1	19.9	2.0
N/A	34.4	53.1	12.5
All Firms	58.5	40.0	1.5

Given the amount of publicity many trade journals have devoted to product liability and the varying risks assumed by different manufacturing sectors, it might be expected that certain manufacturing sectors would be more prone to carry product liability insurance than would others. Somewhat surprisingly, marked contrasts appear minimal (see Table 2). While "Fabricated Metal Products, Tools and Machinery" (generally 34-37 2-digit SIC code), and "Chemicals, Petroleum, Rubber, Plastics" (generally 28-30 2-digit SIC code) are higher than average, only "Food and Apparel" (generally 20-23 2-digit SIC code) and "Wood and Paper Products" (generally 24-27 2-digit SIC code) are substantially different.

Table 2
SMALL MANUFACTURERS CARRYING PRODUCT LIABILITY INSURANCE BY MANUFACTURING SECTOR
(in percent)

Sector	Carry	Don't Carry	N/A
Food and Apparel	75.3	24.7	0
Wood and Paper Products	35.2	63.6	1.2
Chemicals, Petroleum, Rubber Plastics	65.3	31.6	3.1
Stone, Clay, Glass, Concrete	54.4	43.9	1.8
Fabricated Metal Products, Tools and Machinery	66.9	32.8	0.2
Instruments, Clocks, Photographic and Medical Goods	51.7	48.3	0
Other	54.8	43.0	0
N/A	40.0	40.0	20.0
All Firms	58.5	40.0	1.5

SMALL MANUFACTURERS NOT CARRYING PRODUCT LIABILITY INSURANCE

There exist three primary reasons why 40% of the small manufacturing firms surveyed do not carry product liability insurance: "Don't Need Any", "Never Considered It", and "Premiums Too High" (see Table 3). To the question, "Why don't you carry product liability insurance?", 86.3% responded with one of the three aforementioned reasons.

Table 3
REASONS FOR NOT CARRYING PRODUCT LIABILITY INSURANCE
(in percent)

Don't Need Any	38.9	Never Considered It	27.2
Premiums Too High	20.2	Self-Insured	2.1
No Insuror Will Carry Me	2.1	Other	3.1
		N/A	6.4

Smaller small manufacturers give the same reasons in roughly the same proportions as do larger small manufacturers for not carrying product liability insurance (see Table 4). Yet, each of the cited reasons for not carrying product liability insurance can be found more frequently among smaller small manufacturers selected at random than larger small manufacturers selected at random (see Table 5). The reason for this difference simply is due, as seen in Table 1, to the fact that larger small manufacturers firms have a greater propensity to carry product liability insurance. Thus, the variance between smaller and larger firms in this regard is one of degree and not kind.

Table 4
REASONS FOR NOT CARRYING PRODUCT LIABILITY INSURANCE BY FIRM SIZE—FIRMS NOT CARRYING PRODUCT LIABILITY INSURANCE
(in percent)

Gross Receipts (in thousands)	REASONS						
	Don't Need Any	Never Considered It	Premiums Too High	No Insuror Will Carry Me	Self-Insured	Other	N/A
under $100	40.5	24.8	26.4	2.5	1.7	1.7	2.5
$100-$750	40.6	29.7	15.2	1.5	2.3	2.7	7.8
$750 or more	34.4	22.4	27.2	2.4	2.4	5.6	5.6
N/A	35.3	41.2	—	5.9	—	—	17.6

Table 5
REASONS FOR NOT CARRYING PRODUCT LIABILITY INSURANCE BY FIRM SIZE—ALL FIRMS
(in percent)

Gross Receipts (in thousands)	REASONS						
	Don't Need Any	Never Considered It	Premiums Too High	No Insuror Will Carry Me	Self-Insured	Other	N/A
under $100	27.2	16.7	17.8	1.7	1.1	1.1	1.7
$100-$750	19.2	14.0	7.2	0.7	1.1	1.3	3.7
$750 or more	7.9	5.2	6.3	0.6	0.6	1.3	1.3
N/A	18.8	21.9	—	3.1	—	—	9.4

The reason most frequently cited for not carrying product liability insurance is that none is needed (see Table 3). 15.6% of the entire survey sample hold that view. While the data fails to provide sufficient instances to correlate this response to product liability claims filed against firms responding in this manner, small manufacturers not now carrying product liability insurance have had significantly fewer product liability claims filed against them over the past five years than have their counterparts carrying such insurance (see Table 6).

Table 6
FIRMS CARRYING AND NOT CARRYING PRODUCT LIABILITY INSURANCE EXPERIENCING ONE OR MORE CLAIMS IN A YEAR
(in percent)

Year	Carry	Don't Carry
1976 (1st nine months)	7.5	1.9
1975	7.9	1.2
1974	6.6	1.5
1973	3.8	1.2
1972	5.0	1.2

Even then the data contained in Table 6 could be somewhat misleading in that the horizontal variable is based on one point in time (the present) while the vertical variable is five different time periods. Thus, the data is not adjusted for a firm which may have either picked up or dropped coverage within the last 4¾ years, and the survey provides no ability to do so.

Individual firms responding "Don't Need Any" may or may not have an accurate perception of their vulnerability to product liability claims. Obviously, product liability claims have not been a problem for these firms or their response would have been different. But the data seems to indicate many of these firms may be laboring under a false perception, thereby courting disaster. Table 5 indicates only 7.9% of the firms grossing $750,000 or more don't feel in need of product liability insurance, while over three times that percentage of firms grossing $100,000 or less don't feel a need. Since need for product liability insurance coverage is a function of risk, and product liability risk would seem to be more a function of product(s) manufactured than firm size, it is very possible there are a large number of smaller small firms which stand in peril and don't realize it.

The second most frequently cited reason for not carrying product liability insurance is that the firm "Never Considered It". One in ten (11.0%) of all small manufacturers surveyed simply hasn't thought about product liability insurance. This response indicates a low level product liability awareness is found among a healthy minority of small manufacturers.

One probably would suspect the "Never Considered It" response is predominant among the very smallest firms as a low level of awareness is generally associated with that size group.[1] The data does lend credence to this suspicion. 30.9% of firms not carrying product liability insurance and with gross receipts of $50,000 or less have "Never Considered It", in contrast to 18.0% of the firms not carrying product liability insurance and with gross receipts of $1,000,000 or more. But in consolidating size classifications from seven to three for purposes of expanding the number of respondents in each classification, it is found that the middle sized classification ($100,000-$750,000 in gross receipts) most frequently, 29.7%

[1] The term "low level of awareness" is not perjorative and should not be equated with a low level of intelligence

of the time, cite this reason (see Table 4). The smallest of the three classifications ($100,000 or less in gross receipts) cited it 24.8% of the time, and the largest ($750,000 in gross receipts) cited it 22.4% of the time.

As previously discussed, it is very possible there are a goodly number of smaller small manufacturers who mistakenly feel they "Don't Need Any" and, therefore, stand in peril of product liability claims. But the substantial number of firms responding "Never Considered It" virtually guarantees there is a significant percentage of small manufacturers with their heads in a noose. While "Don't Need Any" and "Never Considered It" are not mutually exclusive responses, there is no reason to believe firms which have never considered carrying product liability insurance are significantly less vulnerable to product liability claims than the sample generally.

Regrettably, the survey provides no data to determine whether or not the percentage of firms which have never considered product liability insurance has decreased in the past few years. With increasing attention focused on product liability, it is probable this percentage has decreased and will continue to do so. But that is speculation.

The third most frequently cited reason for not carrying product liability insurance is that the premiums are too high. This reason is cited by one in five firms not presently carrying such insurance (8.5% of all firms surveyed). The significance of this datum is compounded when we recognize that there are firms carrying product liability insurance incapable of affording coverage with higher limits. The question "Are you satisfied with the limit (ceiling per claim) you now have?" was asked of all firms carrying product liability insurance and 29.8% (16.9% of all firms surveyed) responded, "No, but can't afford higher limits" (see Table 7). Thus, adding the two responses, we find exactly one in four small manufacturers surveyed can't afford the product liability insurance coverage desired.

15.0% of the firms currently not carrying product liability insurance did so at one time. Half of that number dropped their insurance because premiums were too high. To date 2.9% of all small manufacturers surveyed have dropped their product liability insurance due to cost. And if reports from NFIB members scattered throughout the country remotely come to fruition, that percentage will escalate rapidly.

All small businesses as a general rule are restrained from raising prices by large businesses dominating the market. As a result, the ability of small businesses to pass through cost increases whether they be insurance or raw materials is subject to the behavior of large firms. This condition is particularly troublesome to small manufacturers as after tax earnings per dollar of sales are substantially less than for large manufacturers.[2]

Reviewing Tables 4 and 5, it is found that firm size has little relevance to affordability of insurance if a firm does not carry product liability insurance with the exception of the middle size classification; but it has substantial relevance when considering all firms, again with the middle size classification being an exception. These data are corroborated in Table 7. This Table reveals a sharp contrast by firm size among those small manufacturers carrying product liability insurance over satisfaction with existing limits. Column "No, but can't afford higher limits" is the item of immediate interest. Affordability is an important factor in determining the product liability insurance limits of small manufacturer, but it is most pronounced among the very smallest.

Note in Table 5 and Table 7 firms with annual gross receipts of $100,000-$750,000, the middle size classification, far more closely resembles the larger classification than the smaller classification in terms of affording desired coverage. The data provides no explanation for this phenomenon. It might be hypothesized that up to a certain break-point, e.g., $100,000 in annual gross receipts, any non-productive cost is substantially more difficult to bear than beyond that break-point. There is evidence that non-productive costs do weigh much more heavily on small businesses than large businesses,[3] but similar evidence comparing smaller small firms and larger small firms is not existent. The phenomenon in Table 5 and Table 7, therefore, requires further investigation if it is to be explained.

An inability (or possibly a refusal) to pay high insurance premiums dwarfs the response "No Insuror Will Carry Me" (see Table 3). But these two responses are not mutually exclusive. The difference between the two may only be a willingness by an insuror to quote a price. If a price quoted is preposterous, then a serious question arises as to whether the premium is too high or whether in effect no insuror will carry the firm. While the point may appear esoteric, it is not; for any action undertaken by an appropriate body must recognize that quotation of a premium price per se is not significant. The significance lies in the affordability of the price quoted.

Table 7
SATISFACTION WITH EXISTING LIMITS BY FIRM SIZE—FIRMS CARRYING PRODUCT LIABILITY INSURANCE
(in percent)

	SATISFACTION				
Gross Receipts (in thousands)	Yes	No, but can't afford higher limits	No, but insuror won't give me higher limits	Undecided	N/A
under $100	29.3	41.3	1.7	22.4	5.1
$100-$750	43.8	28.1	5.0	18.1	5.0
$750 or more	51.5	27.2	3.7	14.2	3.4
N/A	36.4	27.3	—	9.1	27.3
all firms	46.7	28.6	4.0	16.2	4.5

[2] See *Quarterly Financial Report for Manufacturing Corporations*, Federal Trade Commission; series

[3] *Differential Impact of Pollution Control Requirements on Small vs. Large Business in Grain and Stone Industries*, Small Business Administration, prepared by JACA Corp., (Ft. Washington, PA.); May, 1975

For example, an NFIB member in Oregon last year carried $1,000,000 coverage for a premium of $344.00. The best quote obtainable for the firm in 1976 was a premium of $150,000 for $300,000 coverage and a $25,000 deductible. The firm's history shows one claim filed against it over the past five years with a settlement of $12,000. Not surprisingly, this small manufacturing firm elected to drop its product liability coverage. In responding to the survey the NFIB member cited "Premiums Too High" as the reason for not carrying product liability insurance. But were the premiums too high or effectively would no insuror carry him?

Self-insurance is another reason small manufacturers may not carry product liability insurance, but not surprisingly very few small firms opted for this form of protection. The problem for most small firms is the lack of capital, a problem that is not likely to be mitigated in the near future. (For more information on self-insurance see "Commentary on Two Proposed Solutions".)

SMALL MANUFACTURERS CARRYING PRODUCT LIABILITY INSURANCE

With increases in product liability insurance premiums igniting concern over the entire area of product liability, firms carrying product liability insurance were asked what their next premium increase would be.

Table 8
NEXT PRODUCT LIABILITY INSURANCE PREMIUM INCREASE

Amount	Percent of Firms	Percent of Firms—Factoring out "Don't Know" and "N/A" Responses
no major change	15.2	24.4
less than 50%	22.0	35.5
50-100%	13.3	21.4
100-500%	8.7	14.0
500-1,000%	2.1	3.4
1,000% or more	.8	1.3
Don't Know	35.9	—
N/A	2.0	—

The data on Table 8 indicates that premium increases of 100% or more are the exception rather than the rule. In fact, premium increases during the next premium period will be moderate considering what we have been led to believe. Nevertheless, by any other measure, premiums will escalate at an incredible rate.

Over 75% of the small manufacturing firms which knew (or thought they knew) their next product liability insurance premium face major percentage increases; over 40% of these firms face an increase of 50% or more. But the real horror stories to which we have almost become accustomed are not now common.

35.9% of the firms don't know what percentage increase to expect. A large degree of uncertainty should not be surprising considering the volatility of premiums and carriers dropping lines of product liability insurance. However, a mathematical quirk in the data[4] and the fact that smaller small firms are considerably more inclined not to know than are larger small firms, would seem to indicate the degree of uncertainty attributable to the product liability "crisis" is not as great as the 35.9% figure would lead one to believe.

Manufacturers expecting the smallest percentage of premium increase do not vary by firm size. But, practically all firms expecting the largest percentage increase are the largest small manufacturers. This is offset by the disproportionately large percentage of smaller firms which simply "Don't Know". The data offers no explanation for this difference. If it is given, however, that smaller small manufacturers are generally less aware of the product liability problem, and evidence does exist to support this contention (see "Small Manufacturers Not Carrying Product Liability Insurance"), then uncertainty may translate into naivete among a number of firms, thereby, skewing Table 8 in a conservative direction.

Table 9 shows most small manufacturers will pay less than $5,000 in product liability insurance premiums. While the impact of that premium significantly varies between firms grossing $50,000 or less annually and those grossing over $1,000,000 annually, the extremely large premium is certainly the exception rather than the rule.

Table 9
NEXT PRODUCT LIABILITY INSURANCE PREMIUM

Amount	Percent of Firms	Percent of Firms—Factoring out "Don't Know" and "N/A" Responses
less than $5,000	55.8	66.4
$5,000-$10,000	11.9	13.9
$10,000-$25,000	8.2	9.7
$25,000-$50,000	3.0	3.5
$50,000-$100,000	2.4	2.8
$100,000 or more	3.0	3.7
Don't Know	13.1	—
N/A	2.6	—

There exists an obvious correlation between size of firm and size of premium. Yet, significant numbers of larger small manufacturers still will pay less than $5,000 in premiums. Of the small manufacturers grossing $1,000,000 or more annually 39.8% fit into the lowest premium classification. The surprise, however, is the low correlation between industry sector and premium paid. While 28-30 and 34-37 SIC codes generally appear to be paying higher premiums, the difference is relatively small.

Cross-tabulating data on latest rate change and next policy renewal with premium increases (data on Tables 8 and 9) was completed for the purpose of determining whether responses to premium increase questions were influenced by the period when current rates were established or the period the policy is scheduled for renewal. The determination was negative. Those

[4] A striking difference is found between the percentage of firms not knowing the *percentage* of their next product liability premium increase (35.9%) and the percentage of firms generally not knowing the *dollar amount* of their next premium increase (13.6%) (see Table 9). The difference in some degree is attributed to firms with relatively small premiums. Any dollar increase may substantially affect the percentage of increase, but not substantially affect the dollar amount. For example, a firm may currently have a $300 premium and be told the next premium will be anywhere between $600 and $1,200. Under these circumstances, the respondent would not know the percentage increase with sufficient precision to answer but would know the dollar increase with sufficient precision to answer. Further, the failure to adequately refine the smallest response category in the question leading to development of Table 9 (size of next premium) probably gives a false impression over the degree of certainty existing as to dollar amount increases (see "Introduction: Methodology and Limitations of the NFIB Product Liability Survey").

Table 10
SMALL MANUFACTURERS EXPERIENCING A PRODUCT LIABILITY CLAIM*

(in percent)

Year	NUMBER OF CLAIMS FILED 1	2-3	4-5	6-10	10+	Total
1976 (1st 9 months)	3.3	1.2	.4	.1	.2	5.2
1975	3.1	1.5	.2	.2	.3	5.2
1974	2.6	1.5	.2	.2	.2	4.6
1973	1.6	.5	.4	.2	0	2.9
1972	2.5	.8	.1	.1	.2	3.8

* Adjusted for firms in business less than five years

firms whose rates were established more than twelve months ago do not differ in anticipated premium increases (either percentage or dollars) from those whose rates were established less than twelve months ago. Similarly, those firms scheduled for renewal in the next twelve months do not differ in this regard from those scheduled for renewal in more than twelve months.

Most current product liability insurance rates have become effective for the individual firm within the past twelve months. More than two-thirds (68.6%) of the surveyed firms carrying product liability insurance are in this position. 22.0% reported current rates became effective more than 12 months ago and another 9.4% either didn't know or didn't respond. At the same time, 82.8% of these firms indicated their product liability insurance is scheduled for renewal within the next twelve months. Only 10.3% of the respondents are scheduled to have their insurance renewed in more than twelve months with 6.8% either not knowing or not responding. (Note — These two pieces of data measure similar, but not identical activity, for two different time periods. While it is assumed rates will be reviewed whenever the policy is renewed, it is not always true that rates remain unchanged for the duration of a policy.) These data corroborate the apparent growing trend in the industry to sell product liability policies on an annual basis.

CLAIMS AGAINST SMALL MANUFACTURERS

Over the last 4 3/4 years the number of surveyed firms experiencing a product liability claim filed against them has increased dramatically (see Table 10)[5]. Just five years ago, in 1972, 3.8% of the surveyed firms had a product liability claim filed against them. In the first nine months of 1976, 5.2% experienced such a claim. This increase has been steady with the sole exception of 1973.

Given the sharply increasing number of firms experiencing a claim, it is not at all surprising that the total number of claims is also sharply increasing (see Table II). In fact, it is probable that by the end of 1976, the number of claims filed against surveyed firms will be more than double the number filed just five years ago.

The survey provides no data on the size of claims being filed. Comments from individual NFIB members as well as information from other sources lead to the belief they are sharply increasing just as are the number of claims filed. However, the survey provides a more significant piece of data—dollars paid claimants (see Table 12 and Table 13).

Over the past 4 3/4 years, insurors have paid approximately $1,110,000 to persons filing product liability claims against surveyed manufacturers. (Another $166,000 or 13.0% of all dollars received by claimants was paid directly by the firm. These figures simply confirm the generally accepted premise that small manufacturers are highly dependent on insurance to cover their product liability losses.) Each succeeding year with the exception of 1973 has found more and more dollars being paid out by insurors.

Note in Table 13 that most claim settlements involve a relatively small number of dollars. Settlements of less than $1,000 are common throughout the period data was gathered. But the mean is significantly larger than the median in each of the last five years simply because of a few large settlements. In fact, of the $1,110,000 paid by insurors to claimants over the surveyed period, $375,000 or 34.1% was directly attributable to just three claim settlements—one for $175,000 and two for $100,000 each.

Many claims filed against small manufacturers are either dropped or thrown out of court. For example, one respondent resolved eighteen product liability claims over the past 4 3/4 years without one claimant receiving a nickel. Another has had eight resolved with similar results. While the data provides no specific information on claims dropped or thrown out of court, it is known that the average settlement per claim filed (whether successful or not) has been $2,600. Compare that figure with the "Mean" column in Table 13 and note the difference. While as later mentioned, settlements used in the construction of Table 13 tend to involve a disproportionate number of larger claims, the $2,600 average payment per claim lies in stark contrast to the "Mean" column. The implication, of course, is that a

Table 11
PRODUCT LIABILITY CLAIMS FILED AGAINST SMALL MANUFACTURERS BY YEAR*

Year	Number of Claims	Increase from Previous Year
1976 (1st 9 months)	150	—
1975	158	36
1974	122	37
1973	85	2
1972	83	—

* Not adjusted for firms in business less than five years 13.4% of the sample firms are five years old or less.

[5] Claims and suits are not synonymous Claims exist without suits, but suits don't exist without claims.

substantial percentage of claims filed are either dropped or thrown out of court.

While the data reveals a trend toward a substantial increase in the number of product liability claims filed and aggregate payments to claimants by insurors, the data is inconclusive as to the trend in size of settlements. In fact, a plausible argument could be made from the survey data that increased insuror costs (assumed to be the basis for premium increases) are a function of increased claims filed and not of increased settlement sizes.

Table 12
INSURANCE PAYMENTS TO CLAIMANTS BY YEAR*

Year	Aggregate Payments	Increase from Previous Year
1976 (1st 9 months)	$387,551	$ —
1975	281,703	77,532
1974	204,883	121,712
1973	83,171	−68,995
1972	152,166	—

* The dollars in this Table represent resolution of 421 claims. Twenty-six additional claims were resolved during the period, but the payments to claimants, if any, were not ascertainable

PREMIUMS AND CLAIMS PAID—A SUBSTANTIAL DIFFERENCE

(This portion of the survey report is included with a great deal of trepidation. The fear stems not from presentation of the data, but that the data will be lifted out of context and without essential caveats. When drafting the questionnaire for this survey, the relationship between premiums paid and claims paid was not considered an area of fruitful investigation. Therefore, the data on this topic is not as complete as desirable. Yet in analyzing the survey results, the difference in premiums to be paid and claims previously paid is in such extreme contrast, it could not be ignored.)

Small manufacturers surveyed will pay six times as much in product liability insurance premiums during the next year as was paid to all claimants of all surveyed firms over the past 4 3/4 years. It is conservatively estimated that those surveyed firms will pay $6 1/2 million in product liability insurance premiums in the next year contrasting to estimated claims paid of only $1.1 million (see footnote for method of deriving these estimates)[6] over the period for which data was gathered. While the latter figure only represents amounts paid to claimants and does not include such administrative expenses as fighting successful or unsuccessful claims, paperwork in processing

Table 13
SIZE OF RESOLVED CLAIMS*

Year	Mean	Median	Range High	Range Low	Number of Cases
1976 (1st 9 months)	$14,768	$2,000	$175,000	$100	25
1975	5,700	2,966	37,000	30	20
1974	8,093	2,500	47,000	100	23
1973	5,974	3,000	22,000	100	11
1972	9,323	1,200	100,000	50	15

* Table 13 was constructed by hand directly from the survey questionnaires. Since several respondents were compelled to lump more than one claim and possibly more than one settlement into single response columns, only 94 resolved cases could be located where a claimant received a payment that was directly attributable to a specific claim. As will be discussed subsequently (see "Commentary on Two Proposed Solutions"), this isolated claim settlement tends to be larger than the average settlement

[6] From data available in Table 9, it is estimated surveyed firms will pay over $6 1/2 million in annual premiums during the coming year. This estimate was derived by multiplying the number of respondents by the assumed average premium for each response classification and totaling the resultant figures (see Table A).

Table A
ESTIMATING PREMIUMS PAID

Response Classification in Table 9	Assumed Ave. Premium	Number of Respondents	Dollars Paid
less than $5,000	$ 1,000	431	$ 431,000
$5,000-$10,000	6,500	90	585,000
$10,000-$25,000	15,000	63	945,000
$25,000-$50,000	32,500	23	747,000
$50,000-$100,000	65,000	18	1,170,000
$100,000 or more	110,000	24	2,640,000
Don't Know	—	102	—
			$6,518,000

The 102 surveyed firms that responded "Don't Know" obviously will pay an average premium, but since there is no basis for estimation of that premium they have been omitted from the total of estimated premiums paid. Their incorporation would increase the estimate. Since it is known smaller small manufacturers were far less likely to know what their premium will be than larger small manufacturers, and since it is known premiums are related to firm size, the omission of the substantial number of "Don't Knows" from the estimate is not as drastic as it may seem.

(Footnote continued on page 10)

claims, etc., the difference is too substantial to be accounted for by such overhead costs.

Insurance premiums are based on specific actuarial assumptions. These assumptions are rooted in historic patterns. If conditions rapidly change, mooting or at least substantially altering these historic patterns, then actuarial assumptions must change and a new basis must be found for development of new assumptions.

Product liability insurors have been confronted with such rapidly changing conditions. Table 11 and Table 12 illustrate these types of changes. But despite this actuarial nightmare, the data suggests that current actuarial assumptions may be overly pessimistic.

Two NFIB members provided unsolicitated experiences serving to confirm that which the data suggests. The first member, from Arizona, was originally quoted a 1976 premium of $10,000, but according to the proprietor, "The figure was eventually whittled down to a more reasonable figure of $2,500." A similar experience was reported by a member in Ohio. Originally he was quoted a premium of $11,093, and after screaming "bloody murder" had it reduced to $4,492. While a number of factors may have been responsible for insurors in these two instances reassessing rates, it is difficult to believe the magnitude of reduction would have been possible if insurors were confident of the risk upon which their assumptions are made.

NFIB recognizes the difficult straits within which the insurance industry now finds itself. But small businessmen are going bare and being forced out of business by the high rates of product liability insurance. So *if* unwarranted caution is being demonstrated by the industry, then thousands of small businessmen are paying an incredible and unfair price for the industry's insecurity.

THE ECONOMIC IMPACT

The economic impact of the product liability problem can be segregated into three areas: competition, inflation, and employment. Each is discussed separately. While it would be desirable to place a dollar figure to the economic impact of product liability on small manufacturers, the data available does not permit responsible persons to offer such estimates. Suffice it to say there already is an unfavorable impact on competition, inflation, and employment that, if allowed to grow, could have important consequences not solely for the individual firm directly affected, but for the economy as well.

Competition

The inability to obtain product liability insurance, the cost of product liability insurance, and the threat of product liability suits already have reduced the competition of and among small business. This phenomenon can be seen in two ways: product or product lines dropped and failure to develop new products or product lines. (For the remainder of the discussion on economic impact, the word "product" will also refer to "product line".)

4.6% of all firms responding to the survey report they have dropped a product or plan to do so as a result of product liability considerations. This is compounded by another 3.9% indicating they are actively considering dropping a product and a further 5.5% reporting indecision on such action. Thus, one in twenty small manufacturing firms will take a product out of the market exclusively due to the consequences of product liability and slightly less may follow.

17.2% of the firms having plans to drop a product or actively considering such action indicate sales would be reduced less than 5%, while 6.4% report a reduction of 51% or more (see Table 14).[7] The relatively small number of cases in each category does not permit breaking down Table 14 to determine whether impact on the individual firm varies by firm size or industrial classification.

Table 14
IMPACT ON SALES OF FIRMS DROPPING, PLANNING TO DROP, OR ACTIVELY CONSIDERING DROPPING A PRODUCT
(in percent)

Affected Sales	Firms Affected
less than 5%	17.2
5-10%	30.0
11-25%	29.1
26-50%	10.0
51% or more	6.4
N/A	7.3

(Footnote 6 continued)

The "Assumed Average Premiums" are arbitrary figures. Note they do not "split the difference" of a response classification's extremities. Each is on the lower side. The reason for this determination quite simply is that the higher the response classification, the smaller the number of respondents. Therefore, the scatter of responses within a particular response category probably coagulates toward the lower extreme

Estimates of dollars paid claimants are more precise simply due to the method of data collection. Respondents indicated their insurors paid a total of $1,109,474 to claimants over the last 4 3/4 years. Six firms with a total of 26 resolved claims could not recall the amount insurors paid claimants. Since these 26 claims represent only 5.4% of all claims resolved over the period in question and since any significant amount paid would probably be remembered by the respondent, these claims were omitted from the estimate. It is likely the omission of "Don't Knows" from the estimate of premiums paid far outdistance the omission of the 26 claims in question.

[7] Firms indicating they have dropped, plan to drop, or are actively considering dropping a product due to product liability considerations were asked to estimate the percentage of sales affected (see questions #7, #7a, and #7c of the questionnaire located in the Appendix). Despite clear directions that response to the sales impact questions was contingent on a positive response to the previous question, over twice as many respondents claim an impact on sales from product liability as stated they have dropped, planned to drop, or were actively considering dropping a product. The immediate thought was that directions to the respondents were not as clear as they may have originally seemed (see "Introduction, Methodology and Limitations of the NFIB Product Liability Survey"), but in reviewing identical directions in other parts of the questionnaire (Note—questions #10e, #10el, #10f and #10fl) similar problems were minimal. The question then became "if directions are identical why should respondents follow them on one portion of the questionnaire and not on another?" The answer logically appears to be that product liability is having a sales impact on some firms not involving elimination of a product. If this answer is correct, then the impact on sales of product liability would be substantially greater than the data reveals.

Table 14 provides sales impact data *only* for those firms which indicated they have dropped, plan to drop, or are actively considering a product. Other respondents to the sales impact questions have been filtered out.

These data should be considered in light of two important facts: many small manufacturing firms are single product or single line firms. They don't possess the flexibility to shift from manufacturing one product to another. The consequence for these firms dropping a product, therefore, is going out of business. The second fact to consider is that the survey sample does not include any firms that recently may have gone out of business due to product liability. While NFIB has received only isolated reports from its members of firms actually going out of business due to product liability, it is happening.

A second aspect of competition is failure to develop or introduce new products. 12.8% of respondent firms, one in eight, failed to develop a new product (new for their firm) due to inability to obtain product liability insurance, the cost of product liability insurance or the threat of a product liability suit. That is a large percentage even though the question required a projection of intentions which may have been unduly optimistic. (Optimistic in the sense that the small manufacturer may assume potential for a new product that may not exist for reasons of market conditions, inability to acquire sufficient capital, etc.) Regrettably, the impact on competition cannot be measured as there are too many unknown market factors which would have to be considered. However, the substantial number of affirmative respondents demonstrate that product liability stifles initiative to develop new products.

Reduction in competition due to product liability is concentrated in "Chemicals, Petroleum, Rubber and Plastics" and "Fabricated Metal Products, Tools and Machinery". As Table 15 demonstrates, those firms generally classified 28-30 and 34-37 2-digit SIC code are two to three times more likely to drop a product or fail to develop a product as a result of product liability than is the average small manufacturing firm. This data is not surprising and is in accord with general impressions.

Table 15
EFFECT ON COMPETITION BY INDUSTRIAL CLASSIFICATION
(in percent)

SIC Code	Dropped or considering dropping a product	Didn't develop a product
28-30	18.4	24.8
34-37	12.6	17.8
All Firms	8.5	12.8

Contrasting the data found in Table 14 to estimated sales, it appears that small manufacturers surveyed have lost or will lose very roughly 1% of their sales due to product liability considerations. But the impact on competition varies so greatly from industrial sector to industrial sector as seen in Table 15 that it appears virtually non-existent in some industries and rather substantial in others. The implication is that competition is being significantly reduced for the 28-30 and 34-37 SIC codes. Further, failure to develop new products in these areas warrant concern that competition will be reduced even more in the future.

Establishing the general extent to which product liability considerations have stifled the initiative to develop new products is the most significant finding in this survey and one with profound implications for the entire economy. The American standard of living and the economy's ability to absorb increasing numbers of its citizens into the work force is highly dependent on the ability to provide new products and technology. Small business is a major source of such advances. Yet, because of product liability considerations small business is inhibited from developing the new products and technology essential to the growth of the American economy. This point cannot be overemphasized and may be in the long term the most detrimental macro-economic effect of the current product liability "crisis".

Inflation

25.3% of all firms carrying product liability insurance (14.8% of all firms surveyed) report they have raised prices due to the cost of product liability insurance. Another 21.7% (12.7% of all firms surveyed) report they have or will raise prices due to *expected* increases in the cost of product liability insurance. Considering 14.2% (8.3% of all firms surveyed) have not yet decided whether to raise prices due to expected premium increases (the indecision is probably a function of the substantial numbers who do not know what premium increase to expect), it is fair to assume that more than 21.7% of the firms will raise prices due to the next premium increase.

Most price increases due to product liability insurance costs are relatively small. (Data gathered, however, measured the impact on price increases for all products sold by a firm, not on a specific product or line of products.) Table 16 indicates the vast majority are (will be) 5% or less with very few firms experiencing (or expecting to experience) increases of 11% or more.

The survey attempted to discern other product liability related costs that have had an impact on a small manufacturer's sales prices. Responses were too few and too sketchy to provide any systematic analysis. Some firms did report an impact, e.g., a deductible, a small claim paid out of pocket, or an uninsured claim paid. But, it appears such costs have not been a major problem nor have they contributed to price increases.

Table 16
PRICE INCREASES DUE TO PREMIUM INCREASES FOR PRODUCT LIABILITY INSURANCE

Amount of increase for all products sold by the firm	Due to *previous* premium increases		Due to *expected* premium increases	
	All firms	Firms with insurance	All firms	Firms with insurance
1-2%	8.1%	13.9%	5.0%	8.6%
3-5%	4.8%	8.2%	4.5%	7.7%
6-10%	2.1%	3.6%	2.1%	3.6%
11% or more	.3%	.5%	.4%	.7%
Not Yet Determined	—	—	5.8%	9.9%

With the increasing use of large deductibles and the growing number of firms "going bare", non-insurance covered product liability costs will rise. However, it is doubtful these will translate proportionately into price increases. When a large portion of a competitive milieu takes on a non-productive cost such as insurance, the ability for the individual firm to pass on the cost is enhanced. But should an individual small firm solely encounter a non-productive cost, such as a non-insurance covered claim settlement, the ability of that firm to pass it on is low; the firm generally must either absorb the cost or not be competitive. Therefore, premium increases probably will continue to be the factor directly responsible for price increases rather than non-insured costs.

Price increases appear to be more closely related to industrial sector than firm size, but firm size is also a factor. Again, as with competition, the 28-30 and 34-37 two-digit SIC codes are substantially more affected than the average small manufacturer. Differing from competition, however, there exists a low but direct relationship between firm size and having raised prices due to product liability insurance premiums.

Employment

While it is obvious that a product not developed results in unrealized jobs, the survey provides no data that allows the estimation of such lost opportunities. Similarly, the survey is not capable of estimating jobs lost because of product liability-induced price increases causing an inability to compete. However, employment lost due to product liability-induced lost sales is ascertainable (see Table 17).[8]

An estimated 300 employees will lose or may lose their jobs among all 1,296 firms surveyed due to sales losses directly attributable to product liability. This total is approximately 1% of all persons employed by all surveyed firms which roughly corresponds to the estimated loss in total sales.

Obviously, the estimated 300 employees losing or possibly losing their jobs among surveyed firms is not necessarily a *net* loss of employment. Part or even all of the lost sales which caused lost jobs could have been picked up by other firms with a resultant employment increase in those firms. Such information simply cannot be ascertained from a survey of this nature. Nevertheless, the survey shows employees are being released and employment opportunities are not being realized simply because of the product liability problem.

COMMENTARY ON TWO PROPOSED SOLUTIONS

While the purpose of this survey was not to attempt to discover solutions, two questions directly bearing on proposed solutions were included in the questionnaire.

The first was addressed to a frequently voiced complaint of small manufacturers. The question read, "How many of these claims involved products over 15 years old, products substantially altered since you sold them or products not given routine maintenance?" Three conclusions resulted: a relatively small number of claims involving these conditions are made; these claims tend to be singular and are filed against firms with a generally "clean" product liability history; and, payments to claimants for this type of claim are generally large and result in a substantial portion of total dollars paid. Thus, a "statute of limitations" as well as changes in the location of responsibility seem to offer significant potential for gaining control over the "crisis" in product liability.

Of the 598 claims lodged against surveyed firms over the past 4 3/4 years, only 52 were attributed to products more than 15 years old, substantially modified after sale or not given routine maintenance. This amounts to a relatively small 8.7%. Thirty-nine such claims were filed with the 164 firms experiencing only a single claim in any one year. Of the 71 firms experiencing 2-3 claims in any one year, only 12 had claims of this nature. The remainder—one—was filed against the 34 firms experiencing 4 or more claims in a single year.

But in stark contrast to their low numbers is their very high dollar value (see Table 18). Of the estimated $1,110,000 in claims paid by insurors to individuals making claims against surveyed firms over the last 4 3/4 years, an estimated $581,150 or 52.3% was attributed to products over 15 years old, substantially modified after sale or not given routine maintenance. While the data does not permit distinction among these three causes, unsolicited comments frequently accompanying responses seem to indicate the former—products over 15 years old—is the real culprit.

A second proposal, apparently being "kicked about" in government circles, involves a type of self-insurance where specified sums would be set aside for use in payment of claims not covered by insurance, claims in excess of limitations or to cover a large deductible. The questionnaire suggested such a contingency fund might range from $10,000 for very small manufacturers to $100,000 for larger small manufacturers.

Table 17
LOST SALES AND LOST EMPLOYMENT DUE TO PRODUCT LIABILITY
(those reporting losses or expecting losses)

Sales		Employment	
Amount of loss	Firms affected	Employees loss	Firms affected
less than 5%	17.2%	none	30.0%
5-10%	30.0%	1-5	44.5%
11-25%	29.1%	6-10	8.2%
26-50%	10.0%	11-25	10.0%
51% or more	6.4%	26 or more	—
N/A	7.3%	N/A	7.3%

[8] The same phenomenon arose in the number of respondents to questions relating to employment as did on questions relating to sales affected. (see "The Economic Impact Competition"). It was analyzed in the same manner and similar conclusions were reached Likewise. Table 17 was constructed in the same manner as Table 14

Table 18
AGGREGATE PAYMENTS TO CLAIMENTS BY NATURE OF CLAIM AND YEAR

Year	Total payments to claimants	Payments to claimants caused by longevity, modification or maintenance
1976 (1st 9 months)	$387,551	$319,100
1975	281,703	45,700
1974	204,883	63,300
1973	83,171	20,150
1972	152,166	132,900

Not surprisingly, surveyed small firms threw cold water on the proposal. 42.8% of the respondents reported they could not establish such a fund and another 24.8% reported they could do so, but with difficulty. Only 5.9% indicated such a fund was readily possible with 8% already possessing a similar fund. The remainder were either undecided or did not respond.

Among those reporting they could not establish such a fund, firms with gross receipts of $50,000 or less were three times less likely to respond affirmatively than those with $1,000,000 or more in gross receipts. Yet only 10.5% of the latter size classification of firms indicate a capability to establish such a fund without difficulty.

These results should not surprise anyone. Small firms already lack access to capital and establishment of such a non-productive fund would exacerbate an existing serious problem. Therefore, proposals revolving about some type of product liability fund, e.g., tax deductions or credits to help compensate for the non-productive use of capital, are absolutely superfluous for small manufacturers.

AN APPEAL

The unavailability and high cost of product liability insurance is having a major impact on small manufacturers as well as other small businesses not surveyed. But, it must be remembered that unavailability and high cost are generally the effects of the product liability problem—not the causes. While an immediate and short-term solution needs to be found in order to mitigate the effects of product liability, any real solution lies in rectifying the causes. It would, therefore, be tragic if an immediate short-term answer for the effects were assumed to be a final solution.

Product liability is not a problem that will disintegrate from lack of attention. It will continue to prey on small business until a final solution is implemented. Why not then resolve it with the sense of urgency it deserves?

SURVEY OF NFIB MANUFACTURERS ON PRODUCT LIABILITY

Please circle the appropriate answers or fill in the blanks

1. What is your form of business organization?

   [1] Proprietor [2] Partnership [3] Corporation

2. How many employees do you have (full and part-time, including yourself)? _____

3. In what range were your gross receipts during your latest calendar year? (IN THOUSANDS)?

   [1] Under $50 [3] $100 to $250 [5] $500 to $750 [7] $1,000 — over
   [2] $50 to $100 [4] $250 to $500 [6] $750 to $1,000

4. Which of the following *best* describes the type of product you manufacture?

   [1] Food and Apparel
   [2] Wood and Paper Products
   [3] Chemicals, Petroleum, Rubber, Plastics
   [4] Stone, Clay, Glass, Concrete
   [5] Fabricated Metal Products, Tools & Machinery
   [6] Instruments, Clocks, Photographic and Medical Goods
   [7] Other _____ (please explain)

5. How long has your firm been in business?_____ Years

6. Do you carry product liability insurance? [1] Yes [2] No

   (If YES, please complete Part I; if NO, please skip Part I and complete Part II)

   If your product liability insurance is part of "umbrella" coverage, i.e., fire, theft, casualty, etc., try to separate product liability from the others, and answer as best you can.

PART I

a. When did the *current* rates for your product liability insurance become effective?

   [1] Over 12 months ago [2] Within the last 12 months [3] Don't recall

b. When is your product liability insurance scheduled for renewal?

   [1] In the next 12 months [2] In more than 12 months [3] Don't recall

c. What do you expect your next product liability insurance premium increase to be?
   (If your policy extends more than one year, what will be the *yearly* average increase?)

   [1] No major change [3] 50-100% [5] 500-1,000% [7] Don't know
   [2] Less than 50% [4] 100-500% [6] 1,000% or more

d. Approximately how much will your product liability insurance premium be for the coming year?

   [1] Less than $5,000 [3] $10,000 to $25,000 [5] $50,000 to $100,000 [7] Don't know
   [2] $5,000 to $10,000 [4] $25,000 to $50,000 [6] $100,000 or more

e. Will you or have you already raised the price of your products due to *expected* increases in your product liability insurance premiums?

   [1] Yes [2] No [3] Undecided

   I. If YES, what will be (has been) the price increase (assume the increase was spread over all your products)?

   [1] 1 to 2% [3] 6 to 10% [5] Not yet determined
   [2] 3 to 5% [4] 11% or more

f. Have you raised the price of your products due to *previous* increases in your product liability insurance premiums?

   [1] Yes [2] No

   I. If YES, what was the price increase (assume the increase was spread over all your products?)

   [1] 1 to 2% [3] 6 to 10%
   [2] 3 to 5% [4] 11% or more

g. Are you satisfied with the limit (ceiling per claim) you now have?

   [1] Yes [3] No, but insurer won't give me higher limits
   [2] No, but can't afford higher limits [4] Undecided

Please move on to Question 7; skip Part II

PART II

a. Why don't you carry product liability insurance?

[1] Don't need any
[2] Premiums too high
[3] No insurer will carry me
[4] Never considered it
[5] Self-insured
[6] Other

b. Did you ever carry product liability insurance? [1] Yes [2] No

Please move on to Question 7

7. Have you already dropped, or do you plan to drop a product or line of products due to the inability to obtain liability insurance, the cost of product liability insurance premiums, or the threat of product liability suits?

[1] Yes
[2] Actively considering
[3] No
[4] Undecided

a. If YES, what part of your sales were (would be) affected?

[1] Less than 5%
[2] 5 to 10%
[3] 11 to 25%
[4] 26 to 50%
[5] 51% or more

b. If YES, how many employees were (would be) laid off?

[1] None
[2] 1-5
[3] 6-10
[4] 11-25
[5] 26-50
[6] 51 or more

c. If ACTIVELY CONSIDERING, what part of your sales would be affected?

[1] Less than 5%
[2] 5 to 10%
[3] 11 to 25%
[4] 26 to 50%
[5] 51% or more

d. If ACTIVELY CONSIDERING, how many employees would be laid off?

[1] None
[2] 1-5
[3] 6-10
[4] 11-25
[5] 26-50
[6] 51 or more

If NO or UNDECIDED, please move on to Question 8

8. Have you decided not to develop or produce a new (new for your firm) product or line of products due to potential product liability suits, inability to obtain product liability insurance, or the cost of product liability insurance?

[1] Yes [2] No [3] Undecided

9. It has been suggested that all manufacturing firms be required to establish a contingency fund ranging from $10,000 for very small firms, to $100,000 for larger small businesses, to be set aside for use in payment of product liability claims not covered by insurance, in excess of limitations, or to cover the "deductible." How would such a suggestion affect your firm?

[1] Currently have a similar fund
[2] Could establish such a fund
[3] Could establish such a fund, but with difficulty
[4] Could not establish such a fund
[5] Undecided

10. How many product liability suits or claims have been filed or made against your firm over the past five years? (Fill in the blanks. If none in the last five years, leave Question 10 blank and move on to the "Optional Comments" on page 4.)

i) Number of Claims Filed During Indicated Year
1976 ____ 1975 ____ 1974 ____
1973 ____ 1972 ____

ii) How Many of the Foregoing Claims *Were Resolved During the Indicated Year*
1976 ____ 1975 ____ 1974 ____
1973 ____ 1972 ____

iii) Total Dollars Paid to Claimants During Year (No Matter When Claims Filed)
1976 $ ____ 1975 $ ____ 1974 $ ____
1973 $ ____ 1972 $ ____

iv) What Amount of Total Dollars Paid to Claimants was Paid by Your Insurance Carrier During Year (No Matter When Claims Filed)
1976 $ ____ 1975 $ ____ 1974 $ ____
1973 $ ____ 1972 $ ____

a. How many of these claims involved products over 15 years old, products substantially altered since you sold them, or products not given routine maintenance? (Fill in the blanks)

1976 $ ____ 1975 $ ____ 1974 $ ____
1973 $ ____ 1972 $ ____

b. Estimate your direct cost including attorney fees, additional clerical work, time lost in testifying, the insurance deductible, etc., that were *not paid by insurance* resulting from product liability suits filed against your firm. (Fill in the blanks)

Year	*Cost*	*Year*	*Cost*	*Year*	*Cost*
1976	$ ____	1975	$ ____	1974	$ ____
1973	$ ____	1972	$ ____		

c. Have these direct costs resulted in a price increase for your products?

[1] Yes [2] No

I. If YES, what was the price increase (assume the increase was spread over all your products?)

[1] 1 to 2% [2] 3 to 5% [3] 6 to 10% [4] 11% or more

In 1974 our premium was $1,150; in 1975, $7,432; in 1976 they threw us to the wolves and our cost with a new carrier is $40,500. We cannot, and will not, go on like this. We intend to do something before the end of the year regarding closing out our business.

Seattle, Washington

Until last year we paid $165 per year for product liability insurance. This year we are asked to pay $6,300. Our insurance agent wrote, "We have had only one company accept this risk and give us a quote even though we were quite flexible in limits and deductibles desired. I know this is a terrific increase but it is our only offer available..."

Priest River, Idaho

The Federation is made up of a group of small businessmen who, if this problem isn't solved, will become no businessmen.

Toledo, Ohio

Reform is a must! The products liability problem is by far the worst single threat to the existence of our company in the last twenty years.

Boston, Massachusetts

If we do increase prices to compensate for our 400% increase in insurance costs we could very possibly lose customers due to uncompetitive prices. We are caught in a dilemma not of our own making but certainly highly negative in results no matter which way we react.

Hackensack, New Jersey

We always carried products insurance coverage. However when the premium increased 700% we decided to cancel the coverage.

Peabody, Massachusetts

A major claim would put us out of business. Over the life of the company we haven't had a major claim. However, until this year we always carried a $1 million deductible policy at $3-$5 thousand premium. Today this premium is approximately $40,000 (prohibitive).

Saugus, California

We manufacturers who still have the intestinal fortitude to try to remain in business are begging everyone who will listen for help on this matter...do something before it is too late.

Lubbock, Texas

NFIB

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

490 L'Enfant Plaza East, S.W. / Suite 3206 / Washington, D.C. 20024

or

150 West Twentieth Avenue / San Mateo, CA 94403

APPENDIX

Reproduced below are the text and Appendix I of the "Report of the Senate Select Committee on Product Liability" (December 30, 1977) to the Missouri State Senate. This report is the most recently completed state study of the product liability problem that has come to the attention of the Task Force, and it presents a complete and balanced study of the product liability problem in Missouri.

The Missouri report was completed after the publication of the Task Force's Final Report and therefore was not utilized by the Task Force staff. The Task Force wishes to thank the Missouri State Senate, Senator Warren Welliver, Chairman of the Senate Select Committee, and the other members of that committee, for granting the Department of Commerce permission to reproduce this report.

Report of the Senate Select Committee on Product Liability

Committee Members

Senator Warren Welliver, *Chairman*
Route 1, Hartsburg, Mo. 65039

Senator Norman Merrell, *President Pro Tem*
Monticello, Mo. 63457

Senator Don Manford
Suite 1000, Commerce Bank Bldg.
Kansas City, Mo. 64106

Senator John Dennis
Benton, Mo. 63736

Senator George E. Murray
763 New Ballas Rd. So.
Creve Coeur, Mo. 63141

Senator John T. Russell
P.O. Box 93,
Lebanon, Mo. 65536

Senator Gerald Winship
3613 S. Delaware Drive
Independence, Mo. 64055

December 30, 1977

TO THE SECRETARY OF THE SENATE:

In accordance with Senate Resolution No. 293, adopted by the Senate in the 1st Regular Session of the 79th General Assembly on June 15, 1977, the duly appointed members of the Senate Select Committee on Product Liability respectfully submit herewith their report and recommendations for legislation they deem appropriate for enactment at this time.

Senator Warren Welliver, Chairman
District 19
Route 1
Hartsburg 65039

Senator George E. Murray
District 26
763 New Ballas Road South
Creve Coeur 63141

President Pro Tem Norman L. Merrell
District 18
Monticello 63456

Senator John T. Russell
District 33
Lebanon 65536

Senator Donald L. Manford
District 8
Suite 1000, Commerce Bank Building
Kansas City 64106

Senator Gerald E. Winship
District 16
119 E. 23rd, P.O. Box 289
Independence 64051

Senator John Dennis
District 27
Benton 63736

ACKNOWLEDGEMENTS

Committee Staff

E. C. Walker	**Research Analyst, Senate Research Staff**
Bettye Gibson	**Committee Secretary**
Leorae Korsmeyer	**Secretary, Research Staff**
Mary Lou Scott	**Recording and Transcribing**

Special Note

Tom Sullivan	**Director of Research Senate Research Staff**
Ron Kirchoff	**Senate Administrator**
David Valentine	**Research Analyst, Senate Research Staff**
Larry Hall	**Senate Information Officer**
W. Bradford Connor	**Statistical Analyst Division of Insurance**
Deborah Bennington	**National Conference of State Legislatures**

The committee would like to acknowledge, and express gratitude for, the cooperation of the Missouri Chamber of Commerce, Associated Industries of Missouri, Missouri Retailers Association, Missouri Division of Insurance, Missouri Department of Consumer Affairs, Regulation and Licensing, Office of State Courts' Administrator, Missouri Supreme Court Library Staff, Insurance Companies responding to survey and the following members of the Senate staff:

Yvonne Angerer, Dan Berendzen, June Burgess, Roy Green, Roger Henley, Betty Houston, Norma Hughes, Eileen Johnson, Sue Jungmeyer, Diane Kalaf, Agatha Maasen, Faye Mooney, Dixie Nebel, Betty Pratt, Mark Rhoads, Mary Shockley, Terry Speiler, Virginia Tranbarger, Jill Weiss, Hazel Willet.

TABLE OF CONTENTS

Introduction 1

The Hearings 2

Articles, Surveys, Reports 13

The Committee's Surveys 16

Conclusions 18

Recommendations for Immediate Action 19

Recommended further Study 20

Footnote to Industry 21

APPENDICES

REPORT OF THE SELECT COMMITTEE
ON
PRODUCT LIABILITY

INTRODUCTION

The problem of product liability is one of the more complex and serious problems facing businessmen and consumers today, not only in Missouri, but in the nation. In an effort to deal with this problem, the Missouri Senate, on June 15, 1977, adopted Senate Resolution No. 293 establishing a Select Committee on Product Liability. The Committee, created in part because "the cost of product liability insurance . . . has become an intolerable burden on consumers and small businessmen in the State of Missouri," was charged to identify the nature of the problem, determine its causes, consider proposed solutions and "prepare a report together with its recommendations for any legislation it deems appropriate for submission to the Second Regular Session of the Seventy-ninth General Assembly."

The Committee pursued three primary methods of gathering information: 1) Holding a series of public hearings in various parts of the state; 2) Obtaining and reviewing materials - including reports, articles, and surveys - being compiled by others studying this problem; and 3) Conducting its own surveys to compare with and supplement those done by others, and to obtain data not otherwise available.

THE HEARINGS

The Committee held hearings in St. Louis, Kansas City, Springfield, Cape Girardeau and Jefferson City. Witnesses included businessmen, consumers and lawyers from the plaintiff's bar, the defendant's bar and from judicial administration. There was somewhat reluctant participation by the insurance industry. Representatives from the Missouri Department of Consumer Affairs, Regulation and Licensing and the Division of Insurance appeared in the interest of both industry and consumers. In all, the Committee heard testimony from over seventy witnesses, representing a broad cross section of Missouri's citizens.

Soaring Product Liability Premiums

The most clearly demonstrable fact to emerge from these hearings was that premiums for product liability insurance have soared in recent years. Businessman after businessman presented figures to substantiate this fact.

Our company's liability premiums have increased more than 1,000 percent in three years — $69,000 in 1974 to $742,000 this year. We have had only moderate growth in business activity in that period. In addition, and this hurts even more, we now have, for the first time, a $100,000 deductible in our policy.

William Schierholz, President
Chemtech Industries
July 28, 1977 - St. Louis

Our concern regarding product liability is the increased cost that it represents to us as a manufacturer. In our specific case, we were buying $5,350,000 worth of protection for a premium of $2,807 back in 1975. In 1976, this rose to $11,000 per year and in our current fiscal year our premium is $18,000 . . . . . In addition to the premium having gone up 541 percent in the last three years, our protection has gone down from $5,350,000 to $3,500,000, at our own choice in order to keep the premium down. So when you look at it that way our cost has gone up ten times for each dollar of protection.

Rolf Albers, Vice-president
Brasch Manufacturing
July 28, 1977 - St. Louis

In . . . 1976 . . . and for five years prior to that we carried . . . a rate . . . of approximately $3,000 for our product liability coverage. [Our insurance company] notified us of cancellation of that product liability coverage, and we attempted to seek a carrier . . . . We could not find a standard carrier that would even quote us and had to go to what I believe they call the excess market . . . . We finally received about six or seven quotes from this marketplace and accepted the lowest quote, which was . . .$39,000.

Howard Bobroff, Owner
Lawnmower Parts Manufacturing Co.
August 11, 1977 - Kansas City

I want to appear here today to comment on one facet of product liability, and that is the problem supply distributors, cooperatives in particular, have in attempting to obtain product liability or umbrella insurance coverage. Because of the product liability risk, most companies have attempted to obtain umbrella or excess insurance coverage.

In 1974, Missouri Farmers' Association had a policy [covering its milling operations] providing $15 million in coverage at an annual cost of only $17,150. The cost of this policy was the same in 1975, and again in 1976. However, in 1977, the company that carried this coverage . . . refused to renew the policy - even though we had not had a claim under the policy; in fact, have never had an umbrella claim.

In 1977, our company, Missouri Farmers' Association, sought to obtain a new umbrella insurance carrier. We were finally able to obtain a policy at an annual cost of $840,000 . . .with a one million dollar deductible. We cancelled this policy after one month's coverage when we discovered that it did not cover marine risks . . . . Our company has been without umbrella coverage since February of 1977 . . . .

Now the experience of the Missouri Farmers' Association and the MFA Oil Company is not unique. I am familiar with lawyers of other cooperatives and they are having similar problems.

Alfred J. Hoffman
Vice-president and General Counsel
Missouri Farmers' Association
October 20, 1977 - Jefferson City

Witnesses at each of the hearings testified to huge premium increases, some as great as 5,835 percent in a single year. With these huge increases coming so rapidly, many small companies are faced with a choice of doing without product liability insurance, "going bare," or placing themselves in a non-competitive pricing structure in order to pass costs on to consumers - which threatens their ability to stay in business.

Consumer Crisis?

If the cost of product liability insurance forces a company to "go bare," it may create a situation where a consumer who is injured by a defective product will not be able to recover the damages to which he is entitled. In fact, many witnesses, and many of the articles reviewed, pointed out that the real threat in product liability is the threat of a consumer crisis. One manufacturer, who saw his premiums go from $4,000 in 1974-75 to $12,000 in 1975-76, put it this way when he got a premium quote of $60,000 for 1976-77:

We have manufactured 3,650 units and we have never paid a products liability claim. Now when you compare zero out of 3,650 units produced to a $60,000 premium for only effectively $95,000 worth of coverage, those odds . . . from an insurance company's standpoint ought to be pretty good. Since we are a small company, we are not able to come up with $45,000 to $60,000 out of our pockets, so we are going to take that risk. That is a good risk for us. I am not so sure it is a good risk for the consumer because he might own a manufacturing company. We might have to hand him the keys rather than give him a hundred . . . thousand dollars in damages.

Robert J. Johnston, General Manager
Newstyle Homes, Inc.
August 17, 1977 - Springfield

In all, 12 companies that are not carrying product liability insurance appeared before the Committee. This does not include those companies that have resorted to a large deductible in order to maintain some insurance protection. One recent article, entitled "A Consumer Crisis Around the Corner?" warned:

> *Perhaps it makes little sense to talk about a second-level "consumer crisis" in the product liability context when there is still no general agreement on the extent, [or even] the existence, of an insurance crisis for product manufacturers seeking product liability coverage.*
>
> *True, the full economic impact of a decision to "go bare" on a firm and its employees constitutes a crisis of its own. Too little is known today about the long-range consequences of bankruptcies expected to follow in the wake of decisions to go without commercial insurance coverage.*
>
> *Nevertheless, if there is an availability and affordability crisis, or "problem," can a consumer crisis be far behind? Simply put, "going bare," whether by manufacturing firms or professionals, is not just an insurance or business problem.*
>
> *No one seems to know exactly how many firms are going without any commercial coverage for liability at the present time. Certainly some are. Some are compensating by establishing self-insurance reserve funds. Some are crossing their fingers.*
>
> *When consumers find themselves unable to recover damages for bona fide injuries because the product manufacturer has no commercial coverage or has inadequate self-insurance reserves, perhaps then we will hear about a consumer crisis. That day may not be far off.*
>
> **— From** *Product Liability Trends,* **August, 1977**
>
> **Published by —**
>
> **The Research Group International**

Economic Aspects of the Problem

The threat of companies being forced to "go bare" is one problem growing out of the high premiums. Another threat is the potential loss of jobs. Although the Committee did not hear from any witnesses who had been forced out of business due to high insurance costs, a few witnesses testified that they had drastically cut back on employees. One stated that he could only get a reasonable premium if he gave up certain of his plastic products. This meant people in that part of his operation were out of jobs. A St. Joseph manufacturer testified that he used to employ 8 to 10 engineers in research and development; now he has 1 or 2. This same manufacturer pointed to a related problem - the possible stiffling of innovation with the result that new products either are not developed or are not introduced. He stated that he had new products sitting on the shelf which he could not put on the market because of the current situation in product liability.

The manufacturer is the first to see and feel the economic impact when he annually buys his product liability insurance policy for his company. Ultimately, this same cost will be passed through to the consumer.

In an attempt to get this cost factor into perspective, the Committee asked each witness who appeared

to provide us with his cost of liability insurance expressed not only in dollars, but also as a percentage of his company's sales. Percentage of sales probably is the clearest and best indicator of cost to consumers. Table I is a listing for the percentages given by witnesses.

TABLE I

St. Louis

Company	Product Liability Premium as % of Sales
Chemtech	1.5%
Emerson Electric	.3%
Brasch Manufacturing	.4%
Gruendler Crusher and Pulverizing Co.	11%*
Courin Industries	5%
Gilliom Manufacturing	5%*
Watling Ladder Co.	4.25%
McCabe Powers Body Co.	3%
Kansas City	
Richards and Conover Steel and Supply Co.	2%
Lawnmower Parts Manufacturing Co.	2.5%
Butler Manufacturing Co.	2%
Kay See Dental Mfg. Co.	10%*
Gray Manufacturing Co	4%
Springfield	
Acro Trailer Co.	.9%
Anderson and Son, Inc.	3%*
Texco Industries, Inc.	1.3%
Newstyle Homes, Inc.	1.5%*
Cape Girardeau	
Atlas Plastics Corp.	.06%
Dunlap Industries	4%*
Mid-South Steel Corp.	.5%
(Company not named - Insurance Agent example)	.7%
Jim Wilson Company	2.5%
Southern Clay	.3%

Jefferson City

DeLong's, Inc. 1%

*Percentages based on quotes not accepted by the companies. These companies are now either totally or substantially self-insured.

In addition to the testimony at the hearings, two other sources provide some insight into this aspect of the problem. The **Final Report of the Federal Inter-Agency Task Force on Product Liability** (exhibit 55) suggests that nationwide, in the problem industries, premiums as a percentage of sales ranged from one-half of one percent to two percent. Occasionally, percentages as high as 10 percent were found for specific businesses. This committee's survey of Chamber of Commerce members in Missouri (Appendix H) found a range of less than one-tenth of one percent in non-problem areas to over three percent in some cases, with an average of less than one-half of one percent. There is no agreement, either nationally or in Missouri, as to what constitutes a fair and reasonable rate.

The social question which must ultimately be determined is: How much are consumers willing to pay for protection against defects in products and what is a reasonable cost for providing this protection?

A great deal more study will be required before this ultimate question can be answered.

Causes of High Premiums

The problems resulting from skyrocketing insurance premiums - high costs to consumers, companies "going bare", loss of jobs, stiffling of the incentive to develop and market new or improved products, and the threat of forcing small companies out of business - are readily visible. The true cause, or causes, of these soaring premiums are more difficult, if not impossible, to identify and document.

Several witnesses stated that, nationally, there has been an increase in the number of product liability claims in recent years. Many testified that the average amount of those claims has increased. Some witnesses cited huge awards being handed out by juries in products cases where the liability of the manufacturer was questionable at best. None of the cases cited, however, originated in Missouri courts.

In fact, testimony indicated that there are few product liability court cases in Missouri. In Jackson County, only eleven products cases were filed in 1976. The number which came to trial is even fewer. In the Kansas City area (counting two Missouri counties, two Kansas counties and two Federal District Courts) only ten products cases were tried in 1976.

In 1976, in the 22nd Missouri Judicial Circuit (City of St. Louis) - which is the largest in the state - there was a total of 8,078 civil cases adjudicated. Of this number, four were product liability cases. Testimony also indicated that, since 1970, there has been little change in the number of products cases filed or heard.

At the request of the Committee, State Courts' Administrator James Parkison surveyed all of the circuit courts and reported his findings:

Our survey showed that very few products liability cases have been heard in Missouri's circuit courts. Only thirteen circuits reported hearing any products liability cases. The judges recalled verdicts for plaintiffs in only four instances with verdicts ranging from $1,250.00 to $50,000.00. However, the $50,000.00 verdict was subsequently set aside.

James Parkison
State Courts' Administrator
October 20, 1977 - Jefferson City
Exhibit 37

The testimony of the various witnesses indicates the multiplicity of the possible causes of, and explanations for, the rapid rise in premiums. It also shows the variety of the proposed solutions.

At the same time, when our growth has gone up in the four years sixty-some percent, our product liability has gone up 800 percent. And the basic reason for this is consumerism - the growing philosophy that when there is an accident, somebody pays; and it's the company who pays.

L. K. Stringham
Vice-president
Emerson Electric
July 28, 1977 - St. Louis

What I would like to suggest is that perhaps something could be done to relieve the manufacturer of some of the liability if he has submitted his product to such a safety organization as Underwriter Laboratories and that this be considered in any cases against the manufacturer. In other words, there is a means here for determining whether or not a product has been safely designed. Why not use that as a criteria in handling liability suits?

Rolf Albers, Vice-president
Brasch Manufacturing
July 28, 1977 - St. Louis

Most merchandise sold by wholesale distributors passes through the distributor's warehouse to the customer with little, if any, change in the character of the product . . . Even though most wholesalers do nothing to change the character of the product, they are finding that they are becoming more and more involved in product liability law suits.

Robert Diekemper
Treasurer, Hubbell Metal,
Member, Product Liability Task Force,
Missouri Wholesalers
July 28, 1977 - St. Louis

The plaintiff's conduct is taken into account, of course, and under the general tort rules of the tort system when the plaintiff is the sole cause of the injury, there is no one to blame but himself and there is no recovery . . . . The problem is one of judicial erosion . . . . First in the open and obvious risk category, the plaintiff's conduct previously would be a bar to recovery. In products liability . . . courts have allowed a plaintiff, no matter in many cases what his activities have been regarding the use of that product, to go forward and recover.

Patrick Casey
American Insurance Assoc.
July 28, 1977 - St. Louis

There is another intangible unknown because we haven't cost it. When a claim is filed, the amount of clerical and managerial time that goes into researching a job that was installed in 1955, if you will - and any related important data there - is of tremendous magnitude, a lot of hours and a lot of file-digging. And bear in mind that much of the information that might be on computer today . . . was manual entries and much of it in the normal process of cleaning out records is no longer available.

M. A. Schweig, President
Courin Industries, Inc.
July 28, 1977 - St. Louis

I am not worried about lawsuits, if I could ever get to the court. I am worried about the claims. The claims are what take up my time. The claims are what cost the insurance company the money, and the insurance adjustors and the lawyers that they hire. It's not the claims that this attorney . . .was talking about. He gave you a very small statistical figure of the suits that are brought . . . . That's giving you only part of the picture. The real picture is the claims and amount of paper work and the amount of lawyer's fees and the amount of effort of all people that are going into this thing is what has raised this sky-high . . . .

One of my chairs was about eleven years old and one of the legs broke off. . . . This is fatigue, you know. All of us get older and as we get older we can't play handball, we can't play tennis as well as we used to when we were 21. Does everybody recognize that? I do. But do chairs? Chairs have fatigue and after 11 years a leg comes off. So the janitor went and put the three-legged chair back under the table. The next person that sat on it went and fell. Why am I held responsible? I am though. And they tie in everybody - everybody I even buy my steel and my tubing from, and the screws and the nuts and the bolts . . . .

How would you guys like to go - you Senators - to bed at night, knowing that you made three million of these chairs and every one of them is a potential product liability lawsuit anybody tripping over a leg, or a drunk falling out and so forth. If a chair breaks, I have a responsibility, but tripping and drunkenness and silliness, I don't want to have to share that. And three million of them out there - I won't be able to sleep pretty soon when it gets to four million or five million. And you just can't take me back into history, back to 1875 or whenever [some] steel company was formed.

Norman Polsky, President
Fixtures Manufacturing
August 11, 1977 - Kansas City

In the last several years, courts have, and I put this in quotes, "enacted" certain new product liability laws and pressed upon manufacturers and sellers new laws which impose costly and unfair burdens on them. The courts have permitted persons to be compensated:

By a manufacturer, despite the fact that the injury was incurred while the person was using the product improperly, completely ignoring all cautions and warnings . . . .

By the original manufacturer, despite the fact that the injury was caused by a product which was modified after it left the control [of that manufacturer].

Monroe Tallaferro
Butler Manufacturing Co.
August 11, 1977 - Kansas City

Just a few miles north of here, a man made a screw machine years ago . . . . Last fall he was sued for over a quarter million dollars. That machine has changed hands four times. It has been modified at least three or four times in that period of time. A man was injured on that thing and now he is suing for a quarter of a million dollars. The suit was filed, I think, in Atlanta, Georgia. This man has to take himself and some of his staff down there to spend maybe three or four days, or maybe a week or ten days, testifying on this thing and the amount of money involved in this thing, no one knows. And he is right to the point now of whether to continue buying product liability insurance or not buying and taking a chance of another lawsuit. If he has another lawsuit and loses it, he will be out of business. He has already closed a foundry with 25 people employed because of this thing. He cannot afford the product liability for the foundry. He has closed it down - there are 25 people out of work.

Earl Uhler
Associated Industries of Mo.
August 17, 1977 - Springfield

I think it is a twofold problem. I do think that there is a frightened attitude on the part of the insurance companies now, either that or they are trying to get out of the risk business, I am not sure which. But undoubtedly, I think that the premiums in many cases simply do not represent the facts. But also, as a lawyer who hasn't practiced law for a long time, I find it very difficult to recognize a tort anymore as compared with what it was described when I was in law school.

Virgil Anderson
President
Anderson and Son, Inc.
August 17, 1977 - Springfield

-Now we have never had a tort judgement issued on a product liability claim, but one of the big problems is that as soon as there is an accident involving the tractor-trailer unit, the attorney runs out and writes down every trademark he can find on that tractor-trailer and names [them all] as parties to that suit, whether or not there was any failure of the product . . . . One of the problems here is that it costs a minimum of ten to fifty thousand dollars just to defend yourself in these cases and wind up being released from the case. It still cost the insurance company from ten to fifty thousand dollars just to get out of this.

Ralph Looney, President
Reyco, Inc.
August 17, 1977 - Springfield

A point that I would like to make as far as premiums are concerned is that not only are we paying one and one-half percent of our net sales dollars, but also the components that we have in the product that we manufacture -- for instance, a mobile home has an undercarriage or a frame and we buy that from another manufacturer, and he buys his wheels and axles from another manufacturer. Assuming that they pay anywhere near the same percentage that we do, the first manufacturer pays a premium on the wheel and axle; then the frame manufacturer, he pays on his net sales, so he is also paying a premium on the wheels and axle. Then we buy the frame and we pay a premium on the wheels and axle because it is based on sales. Then we sell to a dealer who, again, pays a liability premium on the wheels and axle.

Robert J. Johnston
General Manager
Newstyle Homes, Inc.
August 17, 1977

The one closest to my world is the case of a young man preparing for a career in the diplomatic service who lost his right hand while in the part-time employ of a plastics molding firm. That individual was awarded 1.3 million dollars, some five or six years ago, in a suit against the manufacturer of the equipment involved, even though the equipment was over twenty years old, and had been sold and resold at least half a dozen times, and actually had been relegated to a salvage yard from where it was purchased by the last owner of the machine who, incidentally, made many modifications and to a large extent rebuilt the equipment in order to make it operational. Nonetheless, the original manufacturer of this equipment was held liable to the tune of 1.3 million dollars.

The trouble is that horror stories are no substitute for facts. The plastics industry has been vitally aware of the overwhelming burden posed by the product liability issue and has been working at the national level for quite some time in an effort to develop the true nature of the impact of this issue on the plastics industry. As with many other industries, liability claims against plastics processing companies are growing in size and frequency at an alarming rate. The cost of insurance is soaring, and for some companies, insurance is already unobtainable.

The fallout from this action is entirely predictable -- consumers will be forced to pay higher prices which, incidentally, adds fuel to the fires of inflation; some products may disappear, some companies may be forced out of business with the resultant loss of jobs; and those unfortunate individuals whom product liability laws are intended to protect - the injured -- may also suffer through inadequate or absent insurance protection, or by surrendering a disproportionate share of their damages in legal fees which now take away as much as half of the financial awards.

M. L. Christensen
President
Atlas Plastics Corporation
October 3, 1977 - Cape Girardeau

Current Missouri Law

Despite some stories about what may be happening in a few other states, testimony and exhibits indicate that current law in Missouri on product liability is reasonable. All of the defenses mentioned as desirable by businessmen are currently permissible in Missouri Courts. The doctrine of strict liability, as outlined in the *Restatement (2nd) of Torts* and adopted by the Missouri Supreme Court in *Keener v. Dayton Electric,* 445 S. W. 2d 535 (S. C. Div. 1, 1969) (Appendix E) has not been substantially altered or expanded in Missouri. An experienced defense attorney put it this way in testimony before the Committee:

To put this in the proper frame of reference, their proposition . . . which would say that the manufacturer would not be liable if a change was made in the product by the user or the plaintiff, as the case may be, unless he was injured as a result of something which was in the original, despite some other change. Now that's the law in the State of Missouri. As far as I know, that's the law everywhere, with respect to product liability. If the product has been changed in some essential way and that change is the proximate cause of this guy's injury, the manufacturer has an absolute defense. And I say it really doesn't accomplish anything to have it said twice. It's the case law; it's an absolute defense; and to put it in the form of a statute, I, personally, don't think accomplishes anything.

Thomas J. Wheatley
Defense Attorney
August 11, 1977 - Kansas City

Under Missouri law, the burden of proof clearly is on the plaintiff to prove that a defect caused the injury and that the defect was in the product when it left the manufacturer. However, the passage of time may in effect transfer the burden to the defendant. Again quoting Mr. Wheatley:

A product in use for a period of years, without incident or injury to the user should be presumed to be free of defect. The pursuit of stale claims in this area causes a number of problems to the manufacturer and seller which tend to operate to its disadvantage in successfully defending itself in a case of products liability. And the considerations which I mention in this regard are practical considerations which I have run into in my own practice and experience.

Records, drawings, pictures, specifications, purchase orders, manifests, order acknowledgments, and correspondence all concerning the development, and the design and what the design was, and what the components were and from whom the components were obtained, the assembly, and shipment of the product may be, and more often than not, are not available when lawsuits having considerable age are permitted. I have been called upon to defend products liability lawsuits involving products which left the hands of the manufacturer 25 years ago. The majority of product cases which I am now handling for this client involve sales which antedate the filing of suit by more than 5 years. The kinds of records indicated that are needed for a successful defense, because of the age of the claim, are more often than not unavailable. The availability of such documentation would have materially enhanced my ability successfully to defend the case and of providing the acceptability of the product.

Although the case law is that the obligation rests with the plaintiff to prove that the product at the time of injury is in the same condition, with respect to that portion of it which caused injury, as it was at the time of the accident, my observation is that in reality this burden more often falls on the manufacturer to prove. It is easy for the plaintiff to offer enough testimony either by experts or otherwise to shift this essential burden to the manufacturer. Because of the sheer lapse of time and the absence of such essential records, this task can become most difficult for the manufacturer.

Thomas J. Wheatley
Kansas City

There was clearly a feeling on the part of many witnesses that, whatever the law, there were instances where juries made awards to plaintiffs when they were not deserving. Again, no Missouri cases were cited to support this. It was pointed out at various times during the course of the hearings that, due to the complexities of technical issues and the fact that "experts could argue both sides of a question," juries often faced a difficult task. One witness stated the issue this way:

There is one other thing - I am not a lawyer or anything, but from accounts that I have read of these things, and what I know, it seems that the courts are in a position to where they have to instruct a jury as to what they can do and what they cannot do as to the letter of the law; but I feel that many times these juries hand down a verdict from their heart.

Jim Wilson, President
Jim Wilson Company
October 3, 1977 - Cape Girardeau

Due to the suddenness with which product liability insurance became a problem, the Committee initially faced difficulties with obtaining reliable information. Like much of the testimony at the hearings, the printed information was impressionistic and anecdotal rather than hard, factual data. Other than again documenting the remarkable rise in premiums, the publications reviewed by the Committee in its early days offered little in the way of facts.

Since that time, however, there have been several publications which supply some of the needed data. A complete list of the publications reviewed by the Committee appears in the appendices. The two most extensive and significant reports became available on November 1, 1977: 1) *The Final Report of the U. S. Department of Commerce Interagency Task Force on Product Liability; and* 2) *Insurance Services Office Product Liability Closed Claim Survey: A Technical Analysis of Survey Results.*

The Task Force Report

This is by far the most extensive and inclusive study to date on product liability. The final report is based primarily on studies prepared on contract by professional consultants from three perspectives: insurance, industry and legal.

The final report identifies three primary causes of the current product liability situation: liability insurance ratemaking procedures, the tort-litigation system and manufacturing practices. Pointing out that there is "a tendency for each group that has a special interest" in the problem to blame it on the other groups, the report concludes "that the product liability problem is based on a confluence of causes," (*Final Report,* p. I-16 and I-17).

The report documents the general conclusion of this Committee that: "In the overwhelming majority of cases, insurance company sources did not rely on data (either in terms of number or size of claims) to support premium increases that occurred in the 1974-1976 period," (p. I-18). The report continues, "The burden of proof would appear to fall on the insurers to justify increases of 200, 300 or 400% in premiums where they do not have data based on claims experience that would suggest that increases of this type are proper," (p. I-20).

In its more than 500 pages the final report examines the pros and cons of most of the proposed solutions to the product liability problem. Generally, it avoids making specific recommendations contending that policy decisions should be made by policy makers, i.e., legislators. However, in one area the final report is very clear: There needs to be greater financial disclosure and accountability in product liability insurance. This means that state insurance departments must have access to a substantial body of data to monitor so they "can ensure that rates are fair, nondiscriminatory and reasonably related to product risk," (*Final Report,* p. II-40).

ISO Closed Claim Survey

One of the continuing problems in studying product liability is the lack of adequate statistical data. In an attempt to partially alleviate this, Insurance Services Office, an insurance industry statistical and rating organizaton, conducted a study of product liability claims closed between July 1, 1976 and March 15, 1977. The complete survey results became available in November, 1977, (Exhibit 56).

Before discussing this survey, it is necessary to point out some things it does not do. First, it includes no premium data. This means that there is no way to determine whether the insurance companies participating in this survey had a favorable product liability experience, or whether there is any relation between claims and premiums. Second, the survey covers a short time period and, therefore, does not indicate whether there has been an increase or a decrease in the frequency of products claims. Finally, for the same reason, it does not show whether the average payment for a products claim has increased or decreased. This survey merely provides a look at the facts surrounding products claims closed in a specific time period.

Because of these factors, a question must be raised concerning the methodology used in displaying some of the data in the report. There is a technique used in analyzing insurance claims data called "trending." It is used to project information and trends in claims experience for recent years into future years to establish premium rates for the current year. While this is a perfectly acceptable and, indeed, necessary technique in establishing rates, there is no justification for trending data relating only to claims apart from premiums. The only apparent reason for trending in the ISO survey is to make the average claim payment appear higher than it was in actuality. This does not detract from the validity of the comparative information offered, but it does raise questions about the objectivity of the analysis.

An example of the difference this can make can be gained by using the data from the untrended charts, found in Appendix E of the ISO study, and re-figuring the averages displayed in the body of their report. Table 2-1, pp. 23-24, indicates that the 23 insurance companies participating in the survey paid $113,685,985 closing the 8,017 bodily injury claims on which they made payment, or a countrywide average of $14,181 (excluding claims where the state is unknown). In Missouri, it shows $1,794,515 being spent closing 227 claims for an average payment of $7,905.

However, a different story emerges if the data from the untrended chart (pp. 333-334) are used. The number of claims closed with payment, 8,017, remains unchanged - but the **actual** amount spent is $44,211,839 for an average payment of $5,515. The actual amount paid in closing the 227 claims in Missouri is $927,812 for an average of $4,087. These latter averages are significantly lower than the prominently displayed figures in the ISO Report and are a far cry from the $89,000 average payment figure cited by some witnesses at the Committee's hearings.

There is a further problem with ISO's averages. They immediately exclude the one-third of the claims closed without payment. Although this is an acceptable practice when it is properly marked, as it is in the

complete report, it opens the possibility for misuse of the figures.

This is clearly illustrated by ISO's own display in Table 2 (p. 3) of the "Highlights" booklet (exhibit 39) widely circulated by ISO. This table displays as the average payment per bodily injury claim (including "both those in which insurance payments were made and those in which no payment was made") the figure $13,911. No indication is given that the amount is a trended average - which it is. Even using the trended data the figure displayed is not the average for all claims, as the table implies. The actual figure for the average payment made per closed claim (including those closed without payment), using untrended data, is $3,952. The corresponding figure for Missouri is $2,487.

Despite the care which must be exercised when using the dollar figures displayed in the ISO report, there is an abundance of information about products claims not available elsewhere. In light of the testimony and proposed solutions heard by the Committee, some of the more significant data are presented here, all of it based on nationwide data, because ISO did not report the data on a state-by-state basis.

Employees injured in the course of employment account for 10.6% of the parties receiving bodily injury product liability payments, but they receive 42.0% of the dollars paid. Carrying this one step further 50.1% of the claims, representing 56.3% of the dollars paid as a result of workplace injuries, were caused by the negligence of the employer. These two factors taken together indicate that 21% of the dollars paid in bodily injury claims probably would have been recovered from the employers if employers were not protected by workmen's compensation rules.

The ISO data indicate that old products are not a significant factor in product liability claims. Injuries accounting for 80.8% of payments occur within three years of the first purchase of a product, most in the first year. By six years this figure is 90.7%. Only 4.9% of payments are made on injuries occurring more than 10 years after the date a product is first purchased. Stated in a different way, a statute of limitation running six years from the date of purchase would save insurance companies less than 10% of their losses and one running ten years from that date would save less than 5%. On industrial capital goods, the amount saved would be somewhat higher.

One point made in testimony at the Committee hearings and substantiated by the ISO survey is that defense costs run high in products cases. In bodily injury claims they equal 35% of payments and in property damage cases they add another 48% to the total cost.

Despite statements that unreasonable jury awards are responsible for rising products premiums, only 3.5% of claims, accounting for 9.3% of the payments, reach a court verdict. Additionally, defendants win almost 80% of the cases which are tried to a verdict.

About 8% of the bodily injury claims, accounting for 12% of the payments, involve product modification. However, modification by the injured party accounts for only ½ of 1% of payments. Modifications by the insured accounts for 1.9% of payments and those by an employer account for 4.6% of payments.

THE COMMITTEE'S SURVEYS

In addition to the previously cited survey completed at the Committee's request by the State Courts' Administrator, the Committee conducted several other surveys. A survey was taken of other states to determine what steps they have taken to deal with the product liability problem. The results of this survey are displayed in Appendix F.

With the help of the Missouri Chamber of Commerce, Associated Industries of Missouri, and the Missouri Retailers, Missouri businesses were surveyed on various aspects of product liability. The Committee gratefully acknowledges the help given by those groups. The results of these surveys, along with a brief analysis, are presented in Appendix H. Their findings confirm those of other surveys.

The most extensive survey conducted by the Committee, with the help of the Division of Insurance, was a survey of all insurance companies licensed to sell product liability insurance in Missouri. The data collected constitutes the most complete body of information available on product liability insurance in Missouri. Unlike the ISO survey, the Committee collected premium as well as claims information. A detailed look at this survey is given in Appendix I.

This survey covered 830 claims on Missouri insureds since 1970. Most of these, 664, have been closed since January 1, 1976. This high proportion of recent claims is due to the fact that most of the large insurance companies responding to the survey found it cost-prohibitive to retrieve data concerning claims closed prior to 1976.

Table II displays some of the basic findings on average payments.

TABLE II

	Number	Average Payment of all claims closed	Percent closed without payment	Average Payment on claims closed with payment
Claims closed since 1970	830*	$1,614.00	39%	$2,647.00
Claims closed since January 1, 1976	664	1,207.00	42%	2,077.00
Claims closed before January 1, 1976	146	1,996.00	27%	2,723.00

*There were 20 closed claims reported without the date of closing. They are included on the claims closed since 1970 figures.

It is interesting to note that the average payment per claim is greater in the period prior to January 1, 1976 than since that date in our state, though the data base for the earlier period is too small to draw any conclusions.

Sixty companies responded to the portion of the survey requesting premium information. These sixty reported writing 1976 product liability premiums in Missouri totaling $9,703,058. Eliminating the eleven

companies which did not provide claims information, the remaining 49 companies, those which reported both claims and premiums, had written premiums of $8,919,702. All of the companies together, including those which did not report premiums, reported paid claims since January 1, 1976 of $915,601.

Of the 830 closed claims, only 20 involved products which had been modified by the claimant, which represents 2.4% of the claims. Of these, 15 were closed without payment. The remaining five were closed with payment representing 1.6% of the total amount paid. There were no reported cases involving modifications where a jury found in favor of a plaintiff.

There were 481 claims where the date of the injury and the date of the first purchase were both known. These 481 cases accounted for 78% of the total payments. Of these cases, 94.4% of the injuries, representing 89.8% of the payments, occurred less than two years after the purchase date. Only 2.5% of the cases involved products more than 5 years old, accounting for .6% of the payments. There were 8 cases (1.7% of the 481 claims) where the product was more than 10 years old. However, all but one of these were closed without payment. The amount paid on the remaining claim was $2,635 - or ¼ of 1% of the total paid on the 481 claims.

CONCLUSIONS

Product liability is a serious and continuing problem. There is no "magic" solution - no legislative wand the General Assembly can wave and cause the problem to disappear or go away. Though there is a crisis atmosphere surrounding product liability insurance, the committee could not substantiate a true "crisis." Therefore, it is imperative that the legislature not react in panic.

For the business which suddenly finds insurance unavailable or unaffordable, the situation certainly assumes crisis proportions. If this continues and spreads there is a **future** threat - not only of an insurance crisis and a legal crisis, but also of a **consumer** crisis. The crisis will come if enough companies are forced, due to cost, to go without product liability insurance or to rely on substandard insurance companies. When that happens, consumers will find themselves unable to recover just compensation for injuries caused by defective products.

Before that happens, someone must find the answer on the relation between premiums and losses. Testimony indicates that consumers are willing to pay increased costs to have safer products and to protect their right to recover for damages caused by defective products - but only if the increased costs are reasonable and justifiable - statistically and socially. The Federal Interagency Task Force concluded that "insurers have failed to justify the increases nationally." This Committee concludes that insurers have failed by an even wider margin to justify the increases in the State of Missouri.

The hearings brought forth, primarily from industry, many broad categorical charges of breakdown and deterioration of the existing legal system. Among the testimony of witnesses, the writings and the publications are found the usual suggestions of federal regulation of insurance companies, abandonment of the jury system in favor of handling of claims by judges without juries, arbitration of claims, or the establishment of a no-fault system and payments on a rated basis to all who are hurt by manufactured products. Many urged adoption of statutory defenses most, if not all, of which now exist within our common and case law. Industry related witnesses loudly denounced the allowance of punitive damages in product liability cases. In nearly all instances there was an almost total dearth of factual evidence to support the charges. There will continue to be insufficient factual information to pass on these matters until there is documentation of premiums and losses and further documentation of the manner in which these matters are being handled by our courts.

In fairness to industry, and regardless of the truth or falsity of the general charges leveled against the legal system, the Committee had no difficulty sensing a general distrust of our jury system to make its awards based truly on facts and merit and not upon prejudice or sympathy for the alleged injured consumer. This sense of distrust is not unique with the product liability field, having also been directed at the field of automobile liability and later at malpractice liability. The Committee is well aware that anything that can be done to restore confidence in the legal system, and particularly the jury system, would be a benefit to all of the people, whether manufacturer or consumer, and that such should be a major goal of this Committee.

RECOMMENDATIONS FOR IMMEDIATE ACTION

The Committee makes the following recommendations for immediate action:

1. **That the Insurance Industry, voluntarily and in cooperation with the Division of Insurance, establish a Market Assistance Plan to assist in finding coverage for those businesses unable to find coverage through normal channels.**

This program should follow the format outlined by the National Association of Insurance Commissioners and found successful in other states.

2. **That the Seventy-ninth General Assembly adopt a Product Liability Insurance Reporting Act.**

Such an act would require insurance companies to report to the Insurance Division all premiums collected from Missouri businesses and all claims closed on Missouri insureds. (Proposed Act, Appendix A).

3. **That the Seventy-ninth General Assembly adopt a statute of limitations for product liability actions.**

There was no possible way to analyze the data from our own surveys, the final report of the Federal Task Force, and the ISO survey prior to the beginning of the Second Session of the 79th General Assembly. Under these circumstances the Committee pre-filed the Statute of Limitations Bill as a 5-year statute with a rebuttable presumption of no defect in products over 5 years old. This was done with commitment among the members of the Committee that the question of an absolute cut-off in the statute would be left open in this report, to be finally determined by the appropriate Legislative standing committee based upon the data here accumulated and any subsequent data available (Pre-filed Bill, Appendix A).

4. **That the Supreme Court of Missouri request or direct those charged with drafting Missouri Approved Instructions, namely the Supreme Court Committee on Jury Instructions - Civil, to thoroughly review those instructions being used in Product Liability Actions.**

Specifically they should review and consider the effectiveness of those instructions in submitting for jury consideration the issues and defenses of this complex form of tort litigation.

5. **That the Courts' Administrator of Missouri make further effort, over a period of time, to document the origin and disposition of product liability cases within the State of Missouri for purposes of future study of the problem.**

RECOMMENDED FURTHER STUDY

In addition to the recommendations for immediate action, the Committee believes there are several areas that deserve further study and consideration for possible action in the future.

1. **The General Assembly should watch with interest any federal action on product liability, even though the best information available would lead us to believe that the Federal Government will leave the solution of these problems to the individual states.**

In particular, current Congressional consideration of tax breaks for self-insurance and captive insurance companies should be followed with interest. It may be highly desirable for Missouri to enact legislation giving special consideration to captive insurance companies writing product liability insurance.

2. **The possibility of reducing the volume of court litigation by elimination of subrogation rights in employers and insurers in workmen's compensation cases should be given further study and consideration.**

3. **The adoption of comparative negligence should be studied with particular respect to the effect of that doctrine on product liability cases.**

In this regard, the Committee noted with interest a Missouri Supreme Court decision of November 14, 1977 in the case of *Epple v. Western Auto,* (Mo. banc, Docket No. 59683, Nov. 14, 1977).

The Court considered and rejected a suggestion that they adopt comparative negligence. While accepting that the court could take such an action, the majority refused to do so, arguing that - because of the complexities, the different forms it could take, and the "many policy decisions" involved - "the issue seems suited for **legislative action.**"

4. **The Division of Insurance should study and explore the possibility of requiring that all product liability policies issued within the state shall contain a vendor's endorsement in a form approved by the Division of Insurance.**

Further, the Director of the Division should encourage the National Association of Insurance Commissioners to investigate and study the possibility of developing this concept in all states. The Committee believes that nationwide adoption of a uniform vendor's endorsement in all product liability policies could substantially reduce the numbers of persons required to prepare defenses to the actions resulting in substantially lower defense costs and, ultimately, lower premiums.

FOOTNOTE TO INDUSTRY

Some manufacturers testified during the hearings that they were able to lower their product liability premiums by developing safety programs, instituting proper recordkeeping methods and fighting their claims. These are steps all businesses can take.

There is no law against telling your insurance company that you do not want them to settle product liability cases without your approval. Nationally, 80% of the cases tried to a verdict were won by the manufacturers (ISO Survey, Table 15-3). In Missouri, only 14 cases were reported which reached a verdict - and manufacturers won nine of these (Appendix I).

The Committee respectfully requests industry to cooperate in this method of attacking this serious problem.

APPENDIX G

October 4, 1977

Dear Senator Welliver:

Pursuant to your request, we contacted each circuit judge in the state and asked that he provide us with his best estimate of the number of products liability cases he had heard during fiscal year 1977. It was necessary to accept estimates since records are not currently available which allow access to the precise number of a particular type of case that have been heard.

Our survey showed that very few products liability cases have been heard in Missouri's circuit courts. Only thirteen circuits reported hearing any products liability cases. The judges recalled verdicts for plaintiffs in only four instances with verdicts ranging from $1250 to $50,000. However, the $50,000 verdict was subsequently set aside. It should be noted that several judges mentioned that they were aware of products liability cases that had been filed in their courts but had been settled prior to coming to trial.

The highest incidence of products liability cases occurred in the 16th, 21st and 22nd circuits which are located in Jackson County, St. Louis County and the City of St. Louis respectively. Approximately 15 cases were disposed of in the 16th circuit by dismissal or summary judgment. The number of products liability cases filed there is approximately 20 per year. About 17 cases were heard in the 22nd circuit. The only figure available from the 21st circuit was the number of products liability cases which had been filed which was approximately 50 to 60 cases.

A sheet summarizing the information obtained from the circuit judges is attached to this letter. I hope it provides information that will be useful to you. If you have any questions or we can be of further assistance to you, please do not hesitate to contact this office again.

Sincerely,

(Signed) *James M. Parkison*

Circuit	Number of cases heard	Number of cases won by plaintiff	Approx. verdict
1	3	0	
4	12	1	$1,250
7	1	0	
8	3	0	
12	2	1*	
16	13**	—	
17	3	1	50,000***
21	50-60	—	
22	17	—	
33	5	2	2,500
38	2	0	
40	1	0	

*Verdict was reported as "goodly sum"
**Disposed by dismissal or summary judgment
***Verdict set aside

APPENDIX I

Survey of Insurance Companies

This survey was sent to the 453 insurance companies licensed to write product liability insurance in Missouri. Of these, 115 did not respond and 262 responded that they were not currently writing product liability insurance in Missouri. Of the 76 companies which responded that they are currently writing this insurance in Missouri, 64 supplied usable information. The responses of these 64 are summarized in Tables I-I and I-II.

TABLE I-I

All Companies Responding with Usable Data

No. Giving Premium Information for 1976	Total Premium for 1976	No. Giving Premium and Claims Information	Total Premium	No. Giving Claims Information	Total Paid on Claims Since 1-1-76
60	$9,703,058	49	$8,919,702	54	$915,601

TABLE I-II

Companies Providing Individual Claims Information (including those with no claims)

No. Giving Individual Claims	No. Giving Premium Information and Individual Claims	1976 Premium	No. of Claims Reported	Total No. of Claims Closed	Total Paid	Average Payment
50	46	$8,330,007	1,321	830	$1,339,497	$1,614

The survey asked for information concerning coverage and premiums to be displayed in the following Tables:

Table 1 - Market availability for the product classifications established by ISO.

The responses to this section indicated that availability was not a severe problem in any of these broad classifications. However, for specific products or product lines, there was some indication of availability problems. Since the basic data acquired dealt only with the broad classifications, there is no way to quantify the availability problem from this survey.

Table 2 - Company size by product classification.

Almost every response indicated that the insurance companies did not retain this information in an easily retrievable manner.

Table 3 - Deductibles

Table 4 - Limits

Most companies did not respond to either of these two tables or indicated they did not have the information. Those that responded showed a wide range and no consistency.

Table 5 - Total premiums written in 1971 and 1976 by company size and classification

Very few companies were able to supply premium information for 1971. Those that supplied the information for 1976 generally were unable to break it down either by company size or product classification.

Consequently the only usable premium information is that displayed in Tables I-I and I-II of this Appendix.

The remainder of the survey dealt with individual claims. The companies initially were asked to supply information on each product liability claim filed since January 1, 1971. Very few companies were able to respond for those claims prior to January 1, 1976, and the bulk of the information received was on claims closed since that date or on open claims. In all, information concerning 1,321 claims was supplied. Of this total, 830 were closed claims.

A copy of the portion of the survey concerning claims is attached at the back of this Appendix.

Answers to questions 15, 16 and 17 were few and often obviously inaccurate. Answers to question 12 were too inconsistent to be useful. What information there was indicated processing and defense costs ran from 30% to 45% of the amount paid on claims. The following tables display the relevant data from the remaining questions. Unless specifically noted the tables display only data concerning closed claims.

TABLE I-III

Average Payment on Claims Closed

	No. of Claims	Total Paid	Average Payment	No. Closed without Payment	Percent of Total Claims	No. Closed with Payment	Average Payment On Claim Closed With Payment
Claims Closed:							
Since 1-1-76	664	$801,731.75	$1,207.43	278	41.9%	386	$2,077.03
Prior to 1-1-76	146	291,359.31	1,995.62	39	26.7%	107	2,722.98
Date Unknown	20	246,405.64	12,320.28	7	35.0%	13	18,954.28
Total	830	1,339.496.70	1,613.85	324	39.0%	506	2,647.22

TABLE I-IV

Average Amount Claimed

No. of Claims for Specified Amount	Total Claimed	Average Amount Claimed	Percent Paid of Total Claimed
825	$18,770,717.34	$22,752.38	7.14%

TABLE I-V

Proportion of Claims Closed and Money Paid

at Each Stage of Legal Process

Process Stage:	Number of Claims	Proportion of Total Claims	Number Closed without Payment	Proportion of Total Dollars Paid	Average Payment
Before suit filed	716	86.8%	278	42.3%	$ 783.13
After suit, before judgement	88	10.7	34	49.5	7,457.33
After judgement, without appeal	10	1.2	6	5.4	7,165.80
After appeal	4	.5	3	.3	1,000.00
After suit, not specified	7	.8	3	2.5	4,814.00
	825	100.0%	324	100.0%	$1,607.67

There were three claims closed with payments over $100,000. One for $254,276 and one for $109,000 were paid after suit was filed and before judgement. One for $209,000 was paid before a suit was filed. Although these three claims make up only .4% of the total claims, they account for 42.4% of the money paid.

Of the ten cases settled after judgement and without appeal, 6 were won by the defendants. The largest plaintiff's verdict was for $62,500. The other three averaged $3,050. Of the four cases appealed, three were won by the manufacturer-defendant. The only plaintiff victory on appeal was for $4,000.

TABLE I-VI

Average Number of Months for Time Factors by Claim Size

(Numbers in parentheses are number of valid cases in each category)

Claim Size	Less than $1,000	$1,000-5,000	$5,000-10,000	$10,000-25,000	$25,000-100,000	Greater than $100,000
Time Factor:						
Manf. date to occurrence date*	4 (309)	18 (131)	15 (44)	54 (45)	40 (39)	12 (121)
First sale date to occurrence date*	3 (296)	13 (136)	10 (44)	50 (47)	35 (43)	14 (98)
Occurrence date to date of notice of claim*	3 (496)	7 (206)	9 (66)	11 (72)	21 (66)	80 (152)
Occurrence date to date closed	5 (414)	13 (111)	17 (26)	24 (24)	33 (18)	71 (25)

* These three include open claims

TABLE I-VII

Payments by Length of Time From First Purchase to Occurrence

Length of time from first purchase to occurrence	Total Paid	Average Payment	Valid Cases	Percent of Total Cases	Cumulative Percent	Percent of Total Dollars Paid	Cumulative Percent
Less than 1 year	$682,375	$1,537	444	92.3%	92.3%	64.9%	64.9%
1-2 years	262,016	26,202	10	2.1	94.4	24.9	89.8
2-3 years	30,543	4,363	7	1.5	95.9	2.9	92.7
3-4 years	7,398	1,233	6	1.2	97.1	.7	93.4
4-5 years	62,500	31,250	2	.4	97.5	6.0	99.4
5-6 years	0	0	1	.2	97.7	0	99.4
6-10 years	3,361	1,120	3	.6	98.3	.3	99.7
Over 10 years	2,635	329	8	1.7	100.0	.3	100.0
Total	$1,050,838.15	2,185	481	100.0	100.0	100.0	100.0

Although there were 8 closed claims where the alleged injury was caused by a product over 10 years old, payment was made on only one of them. The other seven were closed without payment. This table clearly indicates that, in Missouri, old products are seldom involved in product liability claims closed with payment. Less than one percent of the money is paid out on products over 5 years old.

TABLE I-VIII

Product Alteration: Amount Paid by Stage of Process

Process Stage	Valid Cases	No. Closed Without Payment	Amount Paid
Before suit	15	13	$ 220 (1 for $200) (1 for $20)
After suit, before judgement	4	2	5,750 (1 for $500) (1 for $5,250)
After judgement, before appeal	0	-	-
After appeal	0	-	-
After suit, unknown	1	0	15,000
Total	20	15	$20,970

The 20 cases represent 2.4% of total claims closed and 1.6% of total money paid.

_____

Name of Insurance Company

SECTION V

The final portion of this survey inquires about claims filed. First, please enclose with your completed survey the annual "Schedule P" loss development statement pertaining to Product Liability coverage for each year since 1970. Secondly, please duplicate the remaining two pages of this survey (items 9 through 19) and supply the requested information for EACH Product Liability claim filed since January 1, 1971. Use separate sheets for each claim. (Please staple separately survey pages 7 and 8 for each claim before returning this survey.)

9. Dollar Amount of Claim_____

10. Dollar Amount Paid to Claimant_____
(Write "None" if settled without paymen
and "Open" if not yet settled)

11. When claim closed:

_____After claim filed, before suit brought

_____After suit filed, before judgement

_____After judgement, without appeal

_____After judgement and appeal

_____Open Claim

12. Estimated cost of:

Claim Processing_____

Court Defense_____

13. Claim Factors:

a. Date product was manufactured or operations completed
_____

b. Date product sold to first retail customer_____

c. Date of purchase by whoever owned it at time of occurrence_____

d. Date of occurrence causing claim_____

e. Date of notice of claim_____

f. Date of first known suit filed against anyone in distribution chain_____

g. Date claim closed_____

14. Was product altered or modified by claimant?

_____Yes _____No

If Yes, did alteration or modification contribute to occurrence?

_____Yes _____No

15. Basis of claim:_____
(e.g. bench error, inadequate testing, faulty design, failure to warn, etc.)

16. Were the following alleged or claimed:

a. Breach of Express Warranty _____Yes _____No

b. Breach of Implied Warranty _____Yes _____No

c. Doctrine of Res Ipsa Loquitur _____Yes _____No

17. Theory of Liability used in settlement or award:

_____Absolute Liability _____Negligence Liability

_____Strict Liability _____Breach of Warranty

_____Other (Specify)_____

18. Check appropriate class and category of company named in claim:

Class	Category
_____Construction	_____Largest
_____Manufacturing	_____Large
_____Transportation, etc.	_____Medium
_____Wholesale and Retail	_____Small
_____Services	_____A-Rated
_____Governmental	
_____Agriculture, etc.	
_____Mining	

19. Were (or Are) there any subrogation or cross-claims involved?

_____Yes _____No

If Yes, explain briefly_____

_____

_____

(Thank you for your cooperation. Please return this survey as quickly as possible to: Senate Research Staff, Senate Post Office, The Capitol, Jefferson City, Missouri 65101)

PENN STATE UNIVERSITY LIBRARIES
A00007095613 9